

**Romania's Integration  
in the European Union.  
Opportunities & Challenges**



Theoretical and Applied Economics. Supplement



## Contents

*Forward* / 9

**Strategic Milestones of Romania's Integration to the European Union  
Process Efficiency**

■ *Gheorghe Zaman* / 11

**Context Vision and the Ultimatum Modernization**

■ *Marin Dinu* / 19

**Internal Rating Approach in SMEs Evaluation**

■ *Mario G.R. Pagliacci* / 31

**Economic and Social Evolution of Romania during 1.I-28.II.2007  
Period**

■ *Vergil Voineagu* / 47

**Romania's Real Convergence to EU - Dream or Reality?**

■ *Cristian Socol, Aura Gabriela Socol* / 61

**The Banking System and Integration Challenges**

■ *Nicolae Dănilă* / 73

**Theoretical Delimitations: the Europeanization of Public  
Administration and its Institutional Levers**

■ *Lucica Matei, Diana-Camelia Iancu* / 93

**The Economic Situation of Romania by the Time of the Adhesion to  
the European Union**

■ *Constantin Anghelache* / 111

**Effects of Integration and Globalisation on Labour Market**

■ *Valentina Vasile* / 141

**Advantages for the Republic of Moldova to Join European Union,  
and the Disadvantages of its Remaining within CIS**

■ *Mihai Pătraș* / 149

**Specific Features Concerning the Market Risk Management**

■ *Gabriela Anghelache* / 163

**The Basis of the Change through Creativity, Responsibility and Hope**

■ *Viorel Lefter, Elvira Nica* / 183

**The Role of Human Capital in the Development of the European Market**

■ *Marina Luminița Sârbovan* / 193

**The Integration of the Romanian e-services Technologies in the European Informatic Society**

■ *Ioan Radu, Minodora Ursăcescu* / 201

**The European Structural Funds for Romania and Opportunities for Bucovina**

■ *Carmen Năstase, Adrian Liviu Scutariu* / 209

**Impact of Romania's Integration into European Union on the Capital Market in Romania**

■ *Leonardo Badea* / 223

**The Regulation of the Energy Market in Romania**

■ *Vasile Robu, Elena Claudia Șerban, Marina Bădileanu* / 231

**EU Regional Policy – Convergence and Economic Growth?**

■ *Mădălina Istrate, Luiza Radu* / 247

**The Institutional Reconstruction and the Functionality of the Macroeconomic System**

■ *Gheorghe H. Popescu, Cosmin Dobrin* / 261

**The Analysis of Potential Output Growth in the Euro Area**

■ *Marius-Corneliu Marinaș* / 271

**Romanian Companies Competitiveness Regarding the European Business Environment**

■ *Iuliana Cetină, Nora Mihail* / 279

**Vertical Integration and Development Potential for European Union**

■ *Dragoș Huru* / 291

## **Content volume II**

### **European Governance through Economic Policies**

■ *Ion Bucur*

### **Economic Convergence and Euro Introduction in the new EU Member States**

■ *Ramona Toma, Virgil Nicula*

### **The Alternative of the Universal Bank-Specialized Banks and the Coordination of Enterprise Financing Activity in Contemporary Banking Systems**

■ *Teodora Barbu, Georgeta Vintilă*

### **Land Fusion – a Priority in Agrarian Policy Action in the Direction of Consolidation the Land Ownership in the Peasants'Households**

■ *Gabriel Popescu, Florentina Constantin*

### **Considerations Regarding the Tax System in Romania – Implications of the Joining Process**

■ *Stela Aurelia Toader*

### **Development Strategies of Vâlcea's Tourism**

■ *Marin Popescu, Sorin Grigorescu*

### **The Principles of the Local Budgetary Process in the Light of the New Law of Local Public Finances**

■ *Cristinel Ichim*

### **Opportunities and Challenges for the MBA Programs in Romania, in the View of Integration in European Union**

■ *Ionel Năftănăilă, Ioan Ursachi*

### **The Actual Stage Liberalization of the Commerce with Services on the Internal Market. Implications for Romania**

■ *Corina Grigorovici*

**Quality Management – an European Approach**

■ *Ion Ioniță, Mihai Mieilă*

**The Normalisation of the Romanian Accounting as a Result of the Compatibility Process**

■ *Alexandru Sălceanu*

**Fiscal Pressure and Property Sense in European Union Integration**

■ *Cristina Covaci*

**Agriculture Development and Employment of Labour Force in European Union's Rural Areas**

■ *Alina Ștefania Crețu, Roberta Mihaela Stanef*

**International Migration. Motivation and Consequences**

■ *Marilena Papuc*

**Economic Growth and Life's Quality in Economic Integration Process**

■ *Rodica Manuela Gogonea, Cătălin Huidumac*

**Innovating – Romania's Stake**

■ *Mina Ivanovici*

**The Constitutional State Exposed to Globalization**

■ *Gabriela Negru*

**Taxation and Accountancy, between National and Regional**

■ *Mihaela Ioneci, Niculina Marcu*

**Economic Growth – Costs and Development Discrepances**

■ *Ion Bucur*

**Accounting in Romania, between Current Taxes and Deterred Taxes Regarding Profit**

■ *Străoanu Boni Mihaela*

**Solving Systems of Difference Constraints**

■ *Gheorghe Manolache*

**Investing in Shares – a Possibility of Financial Investment**

■ *Florentin Șerban, Silvia Dedu*

**Coordinates of Systems and Management Methods in the Health Field**

■ *Carmen Comănescu*

**The Legislative Framework of the Regional Politics in Romania**

■ *Marcela Cristina Hurjui*

**Romania Facing the Integration – a Possible Evolution**

■ *Viorela Iacovoiu*

**Changes in Prior Period Errors**

■ *Alina Pietraru, Dorina Luță*

**Multiple Equilibrium in Decentralized Commerce and Negotiations Models**

■ *Sandu Cătălin Sin*

**The Balance Sheet – Mirror of Patrimony**

■ *Camelia Mihalciuc, Irina Chiriță*

**Flat Tax and Convergence of Romanian Economy with the European Economic Space**

■ *Ioan Done, Adrian Ungureanu*

**Money Laundering – the Consequence of the Financial Globalization**

■ *Carmen Boghean*

**Accounting for the Environment or for Sustainable Development**

■ *Florin Boghean*

**The Pension System in Romania: Past, Present and Perspectives**

■ *Amalia Elena Ioniță*

**The Effect of Training the Tourism**

■ *Irina Ștefana Cibotariu*

*Note: Volume II will be published after Symposium Session*



## ***Forward***

*The adhesion of Romania to the European Union, as from January 1<sup>st</sup>, 2007, implies structural changes at the level of both the economy and the Romanian society. However, the real challenge consists of the success of the integration with the European mode as, finally, the modernization of Romania depends on a successful outcome of this process. Shall we be in the position to valorize this huge opportunity? The Romanian authorities, will they manage to adopt a coherent mix of economic policies able to settle the trade-off between reaching the nominal convergence and the need for a real convergence? Shall we manage to absorb a larger part of the European funds so that we can be in the position to reduce the gaps as against the EU-27 countries? How could we stimulate the convergence potential of the Romanian economy? Which will be the contribution of Romania to the dynamic transformation of the European model?*

*Looking after rational answers to all these question marks, the GAER management decided to propose to the Romanian and international scientific community the Symposium “The Integration of Romania in the European Union: opportunities and challenges”; the first paper works of this symposium being grouped in this volume. The second part of the symposium volume will comprise other significant scientific contributions which, we hope, would set up the very basis of a Romanian sub-model, as part of the European model. This is actually a theoretical elaboration representing both an opportunity and a challenge for the debate of ideas within the Romanian and international intellectual environment.*



# STRATEGIC MILESTONES OF ROMANIA'S INTEGRATION TO THE EUROPEAN UNION PROCESS EFFICIENCY

■

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(Synthesis)

**ABSTRACT.** The strategic milestones of Romania's integration efficiency to the European Union aims at the following more important aspects: developing a national strategy of sustainable development that should have as core the post-accession strategy in agreement with the EU decisions in this field, and the trends at world level; rendering efficient and increasing competitiveness of the public and private sector in Romania; increasing macroeconomic sustainability on long-term, inclusive for the trade balance and for the foreign payments; increasing the efficiency of using domestic and foreign loans and of public investments; using proceeds from privatization for modernizing the infrastructure in Romania; strengthening the management capacity.

The European economic model which is based on the principle of "unity in diversity" offers a flexible framework of rendering compatible on short-, medium- and long-term the economic efficiency, justice and equity, promoting poverty alleviation, social cohesion and inclusion, subsidiarity and intergenerational cooperation.

**Key words:** strategy; integration; sustainable development; efficiency; sustainability of foreign payments balance; European economic model; convergence; catching up.

**REL Classification:** 8A, 20B, 20E

■

1. Romania's accession to the European Union, on January 1<sup>st</sup> 2007, rises a series of issues and aspects of strategic nature *aiming to optimize the integration of our country* from economic, social, technological and

environmental viewpoint on the basis of developing a *sustainable development strategy of Romania within which the post-accession strategy* should represent a *primordial, organic component of the sustainable development* concept, that in the case of our country presupposes:

- ensuring a sustainable rate of growth necessary and sufficient for diminishing Romania's lags against EU average;
- increasing the quality of life, reducing poverty and improving health state;
- maximizing the effects per unit of resources consumption, and the integration costs, especially for the medium- and long-term time horizon.

The large majority of EU member states have developed national strategies of sustainable development, and at EU level it is foreseen to strongly correlate the EU Sustainable Development Strategy (2001-2010) and the Lisbon Strategy (2001-2010) in their revised variants of the years 2005 and 2006.

2. *The prevalence of the private sector* in Romania's economy represents a necessary and favourable factor for improving the economic-financial mechanisms of market operation, which is not enough yet. Integration implies *Strengthening the public-private partnership* at local, regional, national and community level, so that the relative "autonomy" of the private sector's economic development should be stimulated and not obstructed by the institutional capacity, the legal framework and the political decision factors.

Strengthening the role of the private sector within economy and society requires, in parallel to the State support, a strong impetus for company research and innovation, including here the SMEs.

3. Next to changes of the political, economic and social system, that were assumed but also generated, the economic growth achieved by Romania during the transition years presents a series of *vulnerabilities of structural origin* the consequences of which are rendered concrete in:

- *chronic trade balance deficit* that cannot be unilaterally rebalanced just based on promoting exports even if they are those of high added value; in parallel it is necessary to have consistent and compatible strategies with respect to increasing the contribution and efficiency of RDI and technology transfer, and of strategies for substituting "competitive" and "non-competitive" imports; all countries under a more or less transparent form promote policies of efficient substitution of imports having as basis precisely the increase of the innovation, transfer, absorption and technological dissemination capacity (including scientific knowledge) and the expansion of the specialisation and cooperation potential as factor of increasing efficiency and competitiveness;

- *the existence of weak performances* with respect to economic efficiency, eco-efficiency, labour productivity, competitiveness level due to labour force employment structures that are mostly on branches and sub-branches, with relatively low levels of productivity and added value.

4. If we compare cumulatively the GDP growth recorded during the eighteen years of transition with the volume of national and foreign investments, and the one of foreign financial assistance (community and extra-community ones) and the proceedings from privatisation (Lei and forex) we shall find a sensible difference that is unfavourable for the GDP growth on one hand, and a *very fast growth of foreign public debt on medium- and long-term* which diminishes the *sustainability* of the country's foreign payments capacity. Or, exceeding a quasi-standard threshold as share of this debt against GDP, according to the EU and IMF recommendations, might increase the risk of entering into payment incapacity, or might lead to a drastic decrease of the production factors' efficiency.

In our opinion, we should not rely just on the growth of the country's foreign exchange reserves to 21.3 billions Euro at the end of 2006, as compared to a volume of medium- and long-term foreign debt of 27.71 billions Euro for the same year, under the conditions in which the deficit of the trading balance and of the current account record both values that place Romania among the first 15 countries of the world (among them being also Hungary and Poland, after Romania). In future, it might be possible that the dynamics of monetary reserves slows down, because we do not believe that remittances to Romania of the labour force from abroad and the proceedings from privatisation shall maintain the same growth rate. Regarding foreign direct investments (FDI), it is known that these reach in time a maximum ceiling after which, under normal development conditions in the host-country, they start to be replaced by domestic capital.

5. There is an entire specialised literature which analysis to the smallest details the *gaps separating Romania from the average level of EU-12, EU-25 and EU-27*. It might even be said that some researchers have developed even a passion in unveiling the weak positioning of Romania with respect to competitiveness and other economic and social efficiency indicators. Unfortunately, same passion is not displayed, as it should be, with respect to laying the foundations for viable solutions of catching-up (convergence).

I believe that the mission of economists, but not only theirs, is to substantiate and implement such solutions subordinated to national, but also community interests. The duty of the decision factors at superior hierarchical levels is to receive and assess responsibly the respective

solutions. *A decisional error increases the more the cost of the economic, social and any other type of loss*, the higher the decisional level at which it is made because the unfavourable propagation or comprising effects are increasingly higher as compared to the ones of some decisional inaccuracies, for instance, taken at local or micro-economic level.

6. The experience of Romania with respect to the absorption capacity of funds allotted through pre-accession financial instruments is not one of the most satisfying ones. Under the new circumstances, of member country of the EU, the objective of increasing the absorption capacity of structural financial and cohesion instruments must be our concern, more so considering that, on one hand, their volume for the entire period 2007-2013, and, on the other hand, the requirement of complying with the increased exigencies of the procedures for becoming eligible. We do not believe that it is a reason for self-sufficiency or, worse, for commendation if negotiations regarding, for instance, some Sectorial Operational Programmes (SOP) preparing accession to structural funds are halted or interrupted. This means delay in obtaining EU money and time flows to the disadvantage of Romania. The fact that we cannot absorb potentially offered funds and, on the other hand, that we contribute with funds to the community budget or other expenditures for EU programmes indicate also that we lose valuable opportunities. Also, the situation should be avoided in which money of the “strawberry pickers”, for instance, would finance scientific research in other EU member countries.

7. The topic of FDI in Romania, in the new context of EU accession, gains new dimensions, and it should be perceived at the level of the EU internal market, and also at global level because EU integration represents a smaller scale globalisation from the territorial viewpoint, but also a more profound and diversified one, with respect to the forms taken by the instruments and mechanisms for achieving it.

In the case of FDI, the purchasing of state-owned assets by strategic foreign investors as result of the privatisation, of the de-regulation and de-nationalisation process, the complexity of the issue is well-known within the doctrinary framework starting with the slogan “we do not sell our country” to “sale off for a Leu”. We consider that the Romanian state is not strong enough supported by incomes so as to give up “at any cost” to its *efficient* assets from the economic and social viewpoint, or to keep ineffective ones by all means, thus generating losses and financial blocks on short and long-term. It is time that the state, in its quality as “sui-generis” economic agent, clarifies which fields it can efficiently manage, and which not. This, because the *opinion with a “generalisation” character* according to which the state is not a “bad” manager, is in our belief not confirmed but

in some cases, and we cannot understand how the Romanian state entrusts through pseudo-privatisation, practically, to other states the management of its own assets. In a certain way, we might draw the conclusion that the state declines its competence/skill of manager, while other states assume it.

Taking into account that the state assets originate in the former socialist ownership, regarded to belong to everybody, we do not envisage the reconstruction of the ownership rights for confiscated or nationalised assets, but we consider that incomes proceedings from privatisation, those that are still to be obtained, should be allotted for the *modernisation and construction of the public infrastructure*, at least for the following reasoning:

- the infrastructure represents a public good that is very necessary, due to its existing low-level and the EU exigencies in this field;
- Romania makes long-term debts to modernise infrastructures, thus increasing the burden of the foreign debt which, one by no means regard as too small, taking into account the payment capacity in this respect; as long as billions of Euros were obtained from privatisation, why had Romania to resort to bank loans their burden just increasing in the foreign debt?!
- The funds obtained from privatisation would be at any time materially justifiable in public tangible assets which provide for *positive externalities (spillovers)* for all members of the society, doing hence away with any “suspicion” about consumption of state assets on activities that do not increase national wealth.

8. Under the conditions of integration, the issue of *savings and investments efficiency* gains much more relevance given the circumstances of increased competition to which economic agents from Romania must answer.

The data regarding relevant macroeconomic indicators of Romania show that in the period before 1989, and also during the transition period, the growth rate of investments went always ahead the one of GDP, the difference being rather high between the two dynamics. Hence, it results that our investment effort for increasing GDP by a unit is high, and consequently we have a weak efficiency of investments, as a rule, explained by non-performing use of technologies, even in the conditions in which these are hightech. In the private sector, the economic efficiency of investments, as a rule, is higher than the one of the state sector. The increase of investments' efficiency in the two sectors represents a condition for a higher level of competitiveness and performance. It is an unconceivable truth, that now, after 18 years of transition there are still unfinished social-cultural investments! These are one of the most obvious

evidences of public investments inefficiency. EU integration might solve also this issue of Romania.

9. A careful analysis of the "European economic model" applied within EU member states reveals that by the Lisbon Strategy its objectives are focused on growth, social cohesion and employment based on advancement in education and innovation, on increasing R&D expenditures, on liberalising the services' industry, increasing employment and implicitly reducing unemployment.

This model might be an efficient and lasting milestone for Romania so as to avoid either lack of strategies, or too frequent changes thereof, as sign of weakness, non-professionalism, political instability and unpredictability.

In a global world, of interdependent knowledge-based technology, neo-liberal economic models must be revised with respect to the scale of values of the latter. GDP is no longer relevant, common and public goods must be redefined and preserved, and discrepancies triggered by poverty and new inequities must be solved at a global level.

*The vectors of sustainable development and of knowledge-based society* bring back on the agenda the entire structure of the economic model.

The Communication of the European Commission "European values in a global world" referring to the specifics of the European economic model underpins the very special importance of "solidarity and cohesion, equal opportunities and combating all forms of discrimination, health and safety at the workplace, universal access to education and health care, life and labour quality, sustainable development and involvement of the civil society. These milestones are the background of several European economic models, and are included in Europe's option for a social "market economy" based on enforcing the EU treaties, legislation, and the European Convention on Human Rights and the Charter of Fundamental Rights.

The European economic model does not represent a rigid scheme, but a milestone aiming to the following aspects:

- common principles, criteria and values based on various social models, that are generated through "unity by diversity";
- the public sector plays an important role in national regulations and provides high quality services of general interest; in EU a share of 27% from GDP is allotted to social expenditures for social protection against 15% in USA and 17% in Japan;
- integration, harmonisation and cohesion opportunities at European level represent enhancement factors of national economic systems, for instance, by creating the single market and EU structural financial mechanisms;



- partnership and dialogue between governments, industry and trade unions represent economic-social factors of long tradition that are shown by sensibly different mechanisms and instruments from one member country to another.

The European economic model is regarded favourably not only by Europeans, but also by American experts; among them we mention Jeremy Rifkin, who considers that Europe's competitive advantage consists in "preparing a new era while America tries to maintain the old...combining different mixes shaped from the universal rights of men, networks and multi-level government". Rifkin considers that Europe is far better prepared to solve some issues such as life quality, eco-systems, thinking systems, the coping capacity of an information society inclusive and sustainable for all, the general competitiveness strategy that *promotes poverty alleviation, cohesion* and sustainable economic growth.

Even if it is not yet obvious who shall enjoy success in the future, the European alternative of an innovative governance model, according to the interests of all stakeholders, that promotes the creation of values on a longer term, and the performance in assembly seems to undermine the current dominant position of the American economic model which aims at short term and value in preponderantly monetary terms.

The European economic model by the foreseen instruments and policies attempts to strengthen the criterion of *social justice* determining as priority objectives:

- *increasing employment and diminishing unemployment* which in some EU member states reaches very high levels especially among youth, immigrants, women and elderly;
- *a better adjustment between the structure of the educational system and the need of workplaces* in society, and in research;
- *diminishing the gaps between rich and poor* at individual, social groups and EU member-states level, and counteracting the increase trend of these gaps.

The European economic model also acknowledges the limits of the current capitalism for which are applied and suggested a series of amendments, some authors pleading for a "new capitalism" in which more attention is granted to long-term sustainability, to environmental protection, to resources preservation, to infrastructure improvement and cultural reinforcement.

This model imposes the rethinking of the notions of state-nation and sovereignty in close connection with the term of governance at national, European and international level, some experts considering that the regimes of "state-nation" would compromise the future of the "European dream",

and others, to the contrary, maintaining that the “state-nation” preserves its role in the infrastructure of this dream. Even if praised, the European economic model has many critics, as well.

Jurgen Habermas in his work „Après l’Etat-nation” (Fayard, 2000), asserts that “delay in reforming supranational governance resides mainly with the national governments that have difficulties in thinking beyond the state-nation”.

The debates around the Constitutional Treaty reflect precisely a series of insufficiently outlined and applicable aspects of the European governance, of the values that are created as result of “unity in diversity”, as well as of discussing these issues at the level of the citizen in the context of the *multilevel* governance.

In the future, the European model shall need new integration and governance instruments and methods. The increase of internal EU diversity due to the enlargement process led to higher internal heterogeneity, and to the need of internally restructuring the governing system and of enhancing the central government. The limited time horizon of the Lisbon Strategy (10 years) entered in conflict with the strategic processes that require longer periods of time.

The European economic model based on sustainable development reflects the evolution of the system of values, bringing “man back to nature”, creating a global conscience and a new vision on public policies and businesses. It is a challenge to the innovative capacity in the field of governance, and for identifying new governance rules, new instruments of rendering compatible the unity with the increasing diversity.

J. Rifkin shows that: “The European Union is the first governance experiment attempting a coping between the new forces of individualism and integration which restrict human conscience within towards multiple identities of the post-modern person and, outwards, towards the globalising forces of economy”.

The European economic model based on social market economy requires also the *redefining* of national, economic and social interests, taking into account the erosion process of the classical distinction between national and international policies, and also the necessity that functional sub-systems of a complex system, such as EU, shall be also inclusive.

## CONTEXT VISION AND THE ULTIMATUM MODERNIZATION



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**Abstract.** It might happen that Romania faces a lot of problems to sort out in order to get out of its secondary position. But, to the extent of a decisive approach, it has only one major problem: the vision as to getting out of its secondary position. Any detailed approach is almost irrelevant having, to the best, a low strategic relevance in case the overall approach is missing.

While rationalizing is pushing us to focus on the detail, the natural evolution is obliging us to get a picture of the whole at its full extension. The fragment can indeed be better controlled but the efficiency of the control is certified by the effects being globally cumulated effects only. When focusing the effort on the daily issues, both the priorities range and the perspective may become ridiculous. Losing the perspective leads to the situation when the roundabout path, the vicious circle become possible.

Besides, the tendency is not the outcome of the separate parts management but the result of favouring the confluences. The tendency is merely a contextual matter, in which the diversity is negotiating its characteristics and functions on a long term basis.

The evolution cycles should be understood in order to let the economy and the society line up, always, with the tendency side. The key point as regards defeating the un-development, escaping the very last extermination camp which is, actually, the purlieu, consists of the way in which we are defining the fragment mission in order to take the advantage of the infallibility of the whole.

**Key words:** convergence potential; modernization; euro-focussing; societal deficit.

**REL Classification:** 10J, 19H, 20B, 20F



### **1. Formulating the issue**

Connecting the evolution of a country, region or community to the times tendencies represents the very essence of the modernization. The history is proving that this operation has been performed every time, as an undertaken project of the creative segments inside the territorial entities. There are no miracles known in this respect.

Anywhere and anytime the civilization set up and poured out its outcome by traditionalizing the innovation on various plans, starting with the societal one up the technological one (Giddens, 1990). The offsetting mechanism between applying to the goods practice, as fixed by the historical dowry, and the inclination towards the progressive changes, by testing the new and the traditional practices, proved to be the most solid achievement of the developed societies. Invariably, any time, this mechanism to produce performance failed, the un-development became a life mode while getting out of the a secondary position proved to be an adventure of the impossible and endless effort (Chiot, 1976).

It must be noted that setting up the formulas for the connection to the tendencies for getting out of the secondary position has been always linked to the idea of order, including the behaviours as well, to the disseminated knowledge, to the institutionalized innovation as well as to the idea of resources control, concentration of the economic or military power, etc. (Harvey, 2002). In fact, the rationalization keeps on remaining the absolute determinant of the modernization, as it has been initiated along with the enlightenment ideology (Habermas, 2000). The rationalization is in fact the very purpose of the human action, escaped, by secularization, from the emotional constraints of the supernatural. In other words, the evolution as result of a battle for tendencies is not occurring by itself; is it merely the consequence of a project, of an ample and of long run vision, even if, sometimes, it failed into social engineering.

The way to come out with solutions was different from stage to stage as well as from country to country. Anytime there was stake on the miracle of the social engineering, the failure proved to be unavoidable, while in the case the organic vision of the rationalization prevailed as a guide mark and, meantime, as a test of validation for the individual initiative, the welfare accumulations have acted as a rule.

The situation the most frequently met is that one where the historical context is decisive (Weber, 2001). Being inside the context or being outside the context equals to the chance of getting developed or, on the contrary, to get engulfed by the secondary position. During the modern times, there were two contexts: first of all, being inside the tendencies defined by the industrial revolution and the setting up the functional state-nation and, more recently, catching the crest of the globalization, being defined in our case as a project of integration in the European Union (EU) (Dinu, 2006).

## **2. Identifying the project**

The key of success as far as the modernization project is concerned, which support is given by the integration of Romania in the European Union, is represented by the convergence potential (Dinu, Socol, 2006). The perspective governing this determination is a double one: on the one side, the modernization issue by activating the convergence potential is of an ultimatum nature (this meaning the inevitable option under the alternative “either, or”) and, on the other side, the project terms eliminate the doctrinarian dilemma and sharpen the national emergencies (“how” becomes the rule for a “what” already tested by the consolidated welfare experience of the tough nucleus of the EU). The metaphysical propensity, recognizable as to Romanians, is for the first time over the history adventure, forced to become ridiculous against the propensity the European model of integration. This fact implies the consistency with the yielding performance and urges to the identification with the good practices universe. Thus, the self-focusing on the alignments of the specific destiny having an autarchic vocation is diluted by the promises of the euro-focussing. This is just the beginning of founding exercise which exceeds, by its effects, the cycle being opened by the founding myth of our Roman origin and our dependency of the way being traced in the history by the Roman Empire.

The difficulty in positioning the project seems to be a constant of the evolution on these regions (Chiot, 1989). Leave apart the natural, psychological and circumstantial grounds, all real or figured, inherited or assimilated, there is the testimony of the visible data of the reality drawn up thousands of years ago. Despite the fact that these data offers the relevant image of some casual performances, extremely difficult to

ascertain, nevertheless never enough consolidated in order to cancel the un-development reproduction, they are granting to the integration project the super-determinant value of the founding myth as well as the ineffable substance which allows the will to get out of the secondary position to germinate. Obviously we are talking about a potential situation which runs the risk of remaining inert in the absence of consistency commitment, represented by the self-effort, on the rational ground of an undisputable strategy as far as the modernization of Romania is concerned. Practically, this implies:

- 1) a committal vision on the integration in EU, as a modernization process;
- 2) the modernization guide marks to be defined as targets of the real convergence, socially, economically and territorially shaped;
- 3) the strategic instrument to focus on activating the convergence potential, underlying the process of activating the self-effort for development;
- 4) euro-focussing to keep on remaining a strategic on a long run (avoiding thus the traditional run after two rabbits).

The integration exercise has no pre-eminent circumstantial features. Even though such features seem to arise, they should not alter the vision which favours Romania. If the integration is treated as a vehicle for the stringent project of the modernization, maybe the only one we can use on the long run perspective which is specific to this project, any temporary incompatibilities have no more relevance. The transfer of the meaning follows the interest logic i.e., of the interest of braking the vicious circle of the secondary position condition which invariably assimilates and reproduces the un-development.

The persistence in crisis is generating a pathological fixation on ground of the depression, dependence of scarcity, accommodation to failure situations, conflict compensation, poverty preservation, misappropriating the initiative etc.

In a decisive manner, by integration, as a limit project meant to enable Romania to get out of the secondary position, there is the attempt being instituted with the purpose of overcoming the crisis habitude, to rise the performances reached by another model of combining the resources to the rank of motivating values, towards we are aiming also by integration.

### **3. Modernization ultimatum**

Romania acceded to the European process of modernization by about two centuries later. The essence of the modernization process, bearing a contextual relevance of historical nature, depends on the starting of the industrial revolution and of the national revolutions since the XVII-th century (Barbu, 2005).

The attempt of turning the sense of the major options from the tradition of the dependence of the nature rhythms to the accommodation to the innovative changes on a yielding and social level has never been radical and has never resulted in cancelling the secondary position. The modernization which, as far as the Occident is concerned, has been accompanied by the industrial civilization, in Romania remained limited to the starting of the industrialization process, which effects have never get entirely matured. For instance, the eloquent guide mark in this respect is given by the socio-occupational configuration of the population, which keeps a specific component of the pre-industrial economy. Practically, the urbanization and, simultaneously, the endowment of the agricultural activities with industrial technique have dragged on, maintaining even now certain pre-modern features.

In real terms, the modernization, meaning the assimilation of the industrial revolution effects, proved to be a sinuous, incomplete and slow process. Generally speaking, it can be stated out a reduced capacity of accommodation to the modern, of assimilating the social procedures generating the performance. There is a failure in respect of the process meant to institute a self-stimulating state of the modernization, so that the evolution keeps on move within the guide marks of the modernity, in order to reproduce, invariably, the modern sources and resources.

In Romania, the modernization recorded steadily a deficit of modernity, perceived as a backwardness, gap, non-synchronization, inadaptability.

If we agree with the fact that the modernization being started by the industrial and national revolutions resulted in the first modernity while presently we are facing the threshold of the second modernity cycle (Beck, 2003), being defined within the spectrum of meaning of the globalization, for Romania the modernization strategy has exceptional challenges:

- a) the evaluation of the consequences of lack of maturity as far as certain processes typical for the first modernization is concerned;
- b) the limitation, mainly at the socio-cultural level, of the phenomena of blockage as deviating curls of the first modernization, perceived as dilemmatic universe of the post-modernism (Lyotard, 2003);
- c) the projection of the effects of collision between the delayed processes of the first modernization and the processes started by the second;
- d) the setting up of the possibilities to recover on the tendencies of the first modernization, of the opportunities to substitute and to fix the priorities in respect of the approach of the compensating processes and/or new;
- e) the setting up of the sequences of the processes which are typical to the second modernization.

Basically, we are in the situation to manage the superposition of a number of tendencies and processes, which might have a tornado effects. Out of them, those which aim the recovery of the gaps, of temporary, structural or performance wise, are the important ones, as without them the processes typical to the second modernization could not be sustained.

Obviously, in the absence of a coherent identification of the ball of processes, at the crossing of the great passage from one modernization to another, any strategy meant to produce modernity would be irrelevant. The modernization confluence runs the risk to be a conflicting one. Avoiding such a risk means conceiving a modernization strategy as a platform to activate the convergence potential. Otherwise, to bring into the prime-plan of the social action the process which is specific to the integration: real convergence.

The integration of Romania in the EU perceived as a strategy to get access to the second modernization, including the maturity or the compensation of the first modernization processes, is pragmatically limited, on the one hand, to the development of the processes and, to the diminishing of the real gaps which separate us from the development model being targeted and, on the other hand, to the purpose of letting the civilisation performances of the model become effective, within a time horizon which is acceptable from the generating perspective.

For Romania, the second modernization means to entirely reach the social targets of the first modernization, by concentrating the



processes of the second modernization, in order to let the resorts which are generating the capacity to be within the tendency, on the civilisation wave crest.

Practically, in the evolution equation, the real automatic stabilizers as regards the convergence potential are introduced: the systematic constant of the self-effort and the circumstantial capacity to keep on remaining within the tendency.

### **3.1. The systemic constant of the self-effort**

The integrative entities have the capacity of distributing the development. But this is not something which is decisive.

Of course, once the integration achieved, there is the tunnel effect resulting and the option as regards the direction is not unique. The party being integrated is drawn by the gravity force of the whole.

But the integration steadiness depends to the larger extent on what the respective party is deciding to do in order to valorise the dependency gift on the integration way. What we should call as self-effort for integration puts together the resources, both material and will, in order to secure the convergence potential.

There is only one alternative enabling the integrating party to reach the performances of the integrative whole: focussing on the optimum formula of combining the own resources in order to reduce the differences as quick as possible. In fact this is the only one form allowing the party to get out of the secondary position and to avoid running the risk to let a relationship of absolute dependence of the centre yield and distributive feature becoming an eternal one.

We have defined the self-effort as systemic constant meant to multiply, at a real level, the modernizing effects of the integration. The evolution outside the integrating entity would amplify the consequences of the immature or unfinished of the first modernization. It would actually make compulsory that a recuperation direction of the first modernization project is followed which, in fact, would widen the structural incompatibilities with the integrating entity taking the advantage of a developed stage of covering its way in the frame of the second modernization project. Therefore, the autarchic path is out of question.

At a practical level, the self-effort must be forced to turn into bringing about effects, an immediate solution in this respect consisting of investments in infrastructure. In fact, the territorial component of the

social cohesion has, as far as Romania is concerned, the significance of the carburettor for the inner ignition engine. The redeeming on the line of securing the uniform access to the development benefits, extremely critical for Romania, could not be conceived otherwise than in territorial terms, as a modern infrastructure. Coupling effectively the Romania territory to the developed infrastructure of the European Union is representing the essential guide mark of the self-effort, including the absorption of the community support.

Along with and a result of the infrastructure, a decisive drawing effect goes to the investment meant to secure the conditions for the consolidation of the innovating capacity. Even though, as a sensitive theme the issue is avoided by the political class, the deficit of getting connected to the contemporary project of the knowledge society becomes an essential strategic issue. Frankly speaking, the evaluation of the self-effort within integrative processes and entities, such as the European Union, can not be event conceived without a convergence potential based of the innovating capacity, on the ineffable human resource which is the knowledge. There are a lot of gaps which can be short-circuited, somehow even over-passed as a consequence, if the innovating component of the self-effort is consolidated. For instance, there is no chance to achieve quick changes at the level of the socio-occupational structure without investments in the knowledge dissemination and knowledge production. The jumps at the level of the life quality are, the most frequently, the outcome of the changes at the conceptual, of the enlargement of the cultural horizon, of the rational and critical approach of the habitudes and tradition. The equal chances of the access to the technique and cognitive infrastructure prove to be the strategic solution with a decisive impact on the starting of the tendency towards braking up the tie bands which are typical to the secondary position, the real magic formula of the integration success as a project of the second modernization of Romania.

### **3.2. The capacity of remaining within the tendency**

The integration is just a stage of the transition (Dinu et al., 2005). In order to avoid that the transition gets eternal, actually in order to avoid favoring the un-development, exceptional steps of interventionism nature are allowed.

In a way, as an extreme, the transition strategies are drawn up by the social engineering. Obviously, their validity is limited to time horizon which is overlapped, to the best, on the expectation horizons of one generation only. The trans-generational relevance of the social engineering did never imposed in the history and, nevertheless, the projects of the kind failed (Scott, 2007). As the social engineering is forcing the evolution beyond the nature regularities, including those of the human nature, they could not do it but for limited purposes only, which are freely and in majority accepted, on medium terms to the best.

Approaching the integration as an external transition towards a development model implies, on a medium run, a number of characteristics of social engineering. The goal, which is recognized as being a noble one, consists of letting the country joining the most favourable tendencies, where the development cycle distributes the welfare in order to make the coming back to the secondary position situation impossible. For instance, it is not enough to reach the means as development level, from the perspective of the real convergence, but it is necessary to synchronize the evolution with the tendency, to have the required potential in order to avoid the risky deviations from the mean.

As a paradox, when talking about the integrative entities, the advantage of the competition and location are also transitive. The self-effort, understood as an advantage of offsetting diversity in the frame of the integrating entities, as well as the capacity of remaining within the tendency alter the competition sense and, nevertheless moves it away from the exclusive aspects of the competition. Actually, by integration, one party is preparing itself to be more than a competitor having irreducible interests. There is a game to play, out of which everybody must gain by adding the various self-efforts and by making the capacity of entering the tendency of welfare gain become effective. This seems to be a kind of a prescription of utopian nature if it does not get out of the constraints implied by the understanding of the evolution as something different of gain rationalizing, which meaning is, from a societal point of view, the extreme polarisation, mainly as far as the ownership dispersion is concerned, as Pareto taught us.

#### **4. The societal deficit**

The strategic positioning of Romania in the frame of the external transition, as a project of the second modernization, has no economic solutions only. In reality, the larger and the most difficult gap to recover is the one of societal nature.

The most difficult alignment to perceive this kind of gap is given by the mentalities, defined within the sphere of the significances for certain values which form the national specificity (Dinu, 2006). We are not talking here, as it is believed sometimes, about giving up the set of value which we understand as being the Romanian spirit, but that particular feature of this set which makes that, on medium run, the transition becomes almost impossible. Among these values slightly recessive, the most obvious one is given by the foundation of our life style preponderantly on the nature rhythms, which resulted, for the industrialization for instance, in suspending a large part of the population between the urban and the rural culture and the establishment of the social zones failing into intermediate cultures, post-rural and sub-urban.

The mixed mentalities, half-breed or alternatively lived led to behaviours and expectations which combined the life options as well as the organizing models and lucrative activities models. The monetized economy is mixed up with the natural economy at least in respect of the access to the basic foodstuffs. The treatment regarding the public environment, which is typical to the urban cultures, denotes the poor internalization of the specific values. Meantime, it is a symptom of lack of maturity of the processes of forming the social players meant to undertake the public environment according to the democratic scenarios of the game of interests.

Generally speaking, it is admitted that the democracy is the progressive result of learning the behaviour rules starting with the dialogue and ideas exchange, and ending with setting up conventions, by which the good practices for offsetting the individual rights and responsibilities are proposed. The individual discernment, as basis of the public environment, is the sign of assimilating the democracy culture, as process of learning by large segments of time as well as constant exercise of the power management. This is not the case of a theoretical assimilation only but also as a result of a longstanding practice within the

public environment, according to the institutional rules of the democracy (Appadurai, 1996).

Obviously, such deficit is aiming the poorness of the legality culture on the same coordinates of the public environment. Both the societal deficit as to the democracy culture and the one concerning the legality culture are negatively reflected on the process of letting the public institutions become functional, with permanent aspects regarding the legitimacy, authority and competence.

The weak adherence to ample strategies of duration, even the absence of such strategies aiming large transforming projects, such as the one of the post-communist transition, the slowness in sorting out, in the frame of the public environment, the process of initiating the strategies drawing up, such as the post-adhesion strategy, indicates in a undeniable manner the significant deficit on the societal plan.

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## INTERNAL RATING APPROACH IN SMEs EVALUATION

■

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**Abstract.** *The purpose of this article is to analyse some contents of Basel 2 Accord concerning the evaluation of credit risk connected to borrower enterprises, with particular reference to SMEs.*

**Key words:** credit risk; public control system; banking regulations; rating evaluation.

**REL Classification:** 7C, 17B

■

### The new basel capital accord

Bank System demonstrate to be fragil.

A study made by *International Monetary Found* shows that 131 countries (among 180 member countries) suffered big banking crisis, in period 1980-1996. In developing countries generally there were systemic crisis, while in developed countries such crisis involved single banks (except in Japan); in any case they seriously demonstrated to put relevant doubts about the efficacy of public control systems and the reputation of supervision authorities.

IMF analysis outlines that in all countries, in any situation, banking crisis are generated by a set of causes clearly defined:

- bad quality of credits;
- links between banks and industries, generating distortion in credit allocation;
- insufficient bank liquidity;
- insufficient bank capitalization.

In countries of more recent development, these factors are increased by other causes linked with macroeconomic disequilibrium, weak institutional infrastructures, connection with criminal organisations.

Phenomena of bank crisis put in evidence the need to re-examine duties and effects of banking regulations and instruments of banking supervision, each of them in order to pursue the aims of sound and prudent banking management:

- capacity of banks to generate and to maintain acceptable levels of profitability;
- risk assumption balanced with adequate capitalization;
- operative behaviour in respecting of laws and supervision directives.

The New Basel Capital Accord (Basel 2) is inspired by these principles: its object is to reinforce the ratio *own-capital/typical-risks* in banks, according to the following formula:

$$P \geq P(\text{rm}) + P(\text{ro}) + 0,08 \times \text{APR}$$

Where:

- P: level of capital to be taken over;
- P(RM): quote of capital hedging the market risk;
- P(RO): quote of capital hedging the operative risk;
- APR: amount of credit investments weighed by the credit risk.

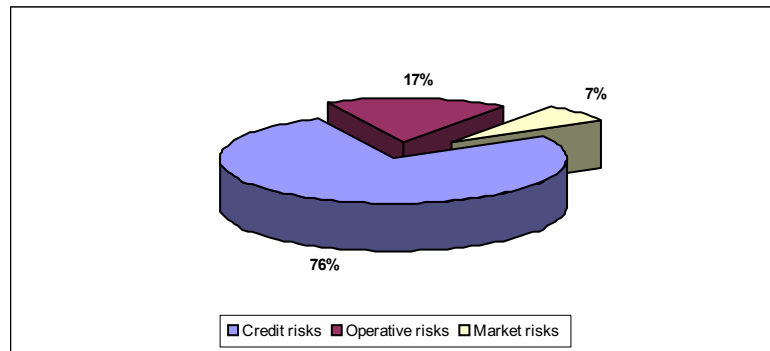
The different kind of risks have a different impact in capital taking over.

Figure 1 shows that credit risk plays the most important role (76%), and banks have to develop good practices in order to control this kind of risk. Operative risks and market risks have lower weights (17% and 7%).

Basel Committee aim is particularly focused on the development and implementation of *Risk Management*, by introducing some important innovations about:

- corporate governance and strategic structure of capital in financial institutions;
- measuring and managing ratio capital/risk;
- transparency in financial information to market agents;
- methods and practices in assuming, managing and controlling risks.

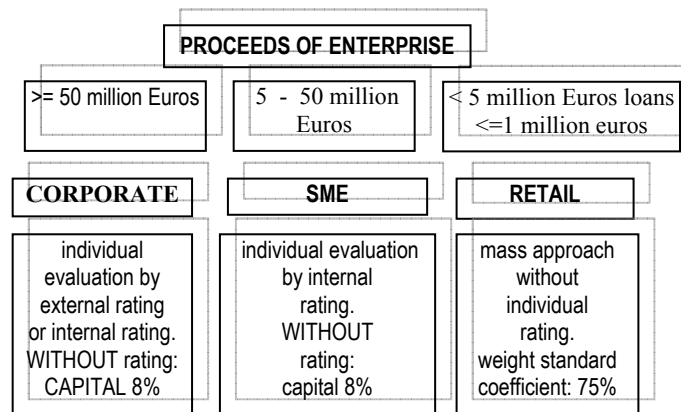




**Figure 1.** Risk weights in the capital taking over

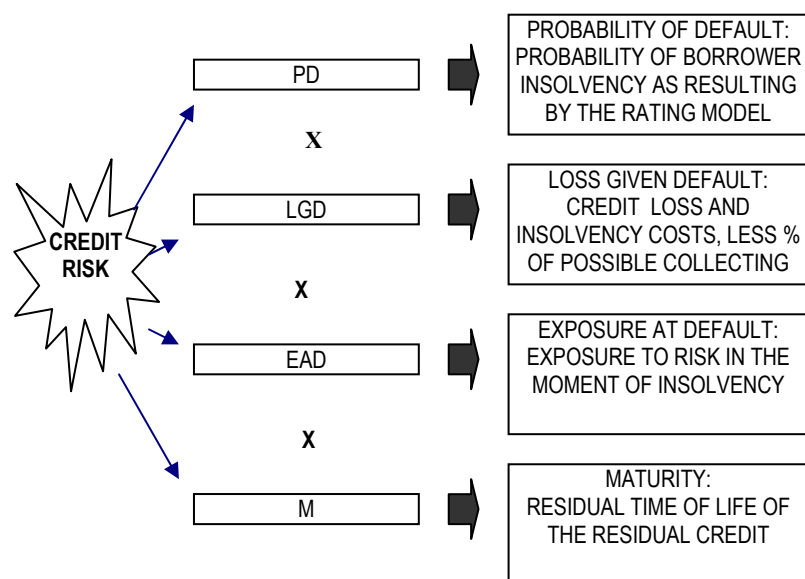
### Evaluation of enterprises by using rating methods

The New Basel Capital Accord takes account of the enterprise size, according to the model showed in Figure 2.



**Figure 2.** Enterprise model for risk evaluation method

The banks have to class their clients according to a rating classification, associated with a measuring of credit risk (see Figure 3).



**Figure 3.** Clients classification accordint to the rating

Basel 2 settles the guide-lines, and any bank can choose the methodology and the procedures for measuring rating, according with its own organisation and behaviour modalities.

*Standard approach* is an approximate method, and the effect is similar to Basel 1, with a capital setting of 8% on each bank credit. The main correction introduced by the New Accord is in using some ponderation coefficients of the credit quality, according with the external ratings issued by the specialized agencies.

The banks using the *standard approach* separate their credit portfolio in two areas:

- loans to clients with a rating issued by a specialized agency: they have a specific ponderation and generate a diversified capital setting as far as the minimum of 2%;
- loans to clients without an external rating: the capital setting is 8%.

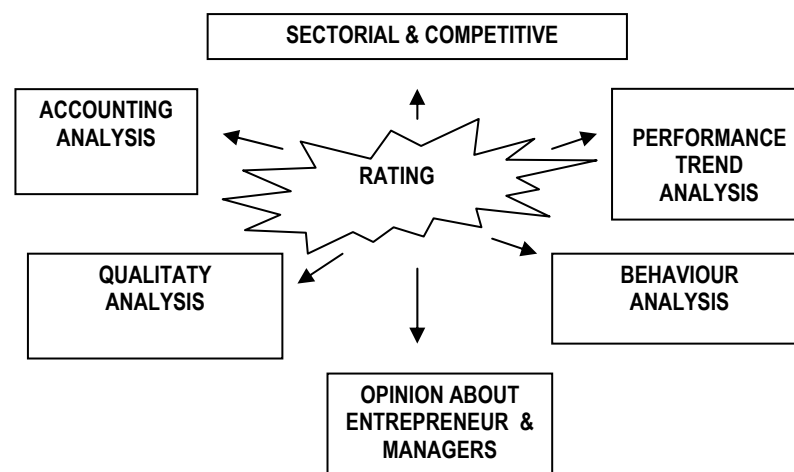
With *Internal Ratings-Based Approach (IRB)* the banks have the possibility to make use of an internal rating system, under the condition it is accepted by supervision authorities.

The way of internal ratings represents the real innovation introduced by the New Accord, because it allows the measuring of credit risk directly connected with the solvency peculiarities of each borrower.

Two approaches are possible:

- *Foundation Approach*: bank estimate PD only, while other factors (EAD, LGD, M) are estimated by the supervision authority;
- *Advanced Approach*: bank estimate all the components of credit risk.

Internal rating systems need high organizing costs, but in the same time they make allowance for the effective quality of credits, so that the banks with good clients have to settle a lower capital. The organizing costs in order to implement an internal client-risk evaluation are referred to collection, selection and analysis of information that are necessary to issue a complete rating estimation (see Figure 4).



**Figure 4.** Costs organization as function of rating systems

In summary, three categories of information have to be used:

- 1) *Quantity Information* about economical-financial aspects of the enterprise: they can be found in balance-sheet and other accounting documents.

Particular importance must be given to:

- capacity of self-financing;
- estimation of net tangible capital;
- entity and performance of working capital;
- composition and impact of interest;
- etc.

2) *Quality Information* about a lot of phenomena not directly expressible in numerical form.

Very important are information about:

- owners, governance, organization;
- equity participations and links with other companies; presence in informal groups;
- typology of products/services, kind of markets, channels of selling;
- characteristics of economic sector, competitive position, market quota;
- trade marks, patents, know-how, special technologies;
- information about production plants;
- availability of economic-financial budgets and other forecast plans;
- etc.

3) *Performance Trend Information* in relationship with banks. The main sources are supplied by supervision authority (consolidated data in the Risk Centre) and by the historical data handled in any single bank.

The most important data concern:

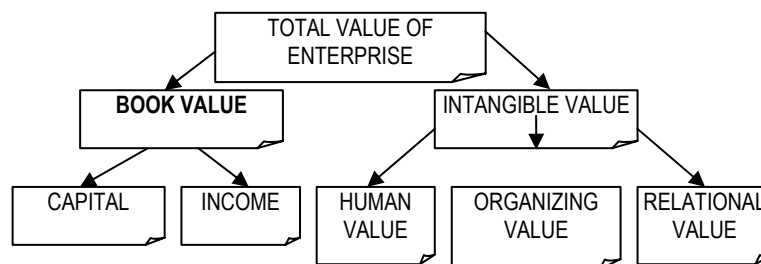
- entity of the limits of credit;
- frequency in exceeding the limits of credit;
- level of flow in bank accounts;
- number of bank relationships;
- quality of the bill portfolio;
- etc.

It is understandable that the most difficult category of information to collect is *Quality Information*, because the news are not found in balance-sheet and other accounting documents, nor in historical files of banks. *Quality information* are available in the internal of the enterprise generally, and they are considered as "confidential" often; only a few of the big companies are used to publish an *Intangible Balance* where it is

possible to find a lot of interesting information. Otherways, it is necessary to set up new sources of information and new techniques of analysis<sup>(1)</sup>.

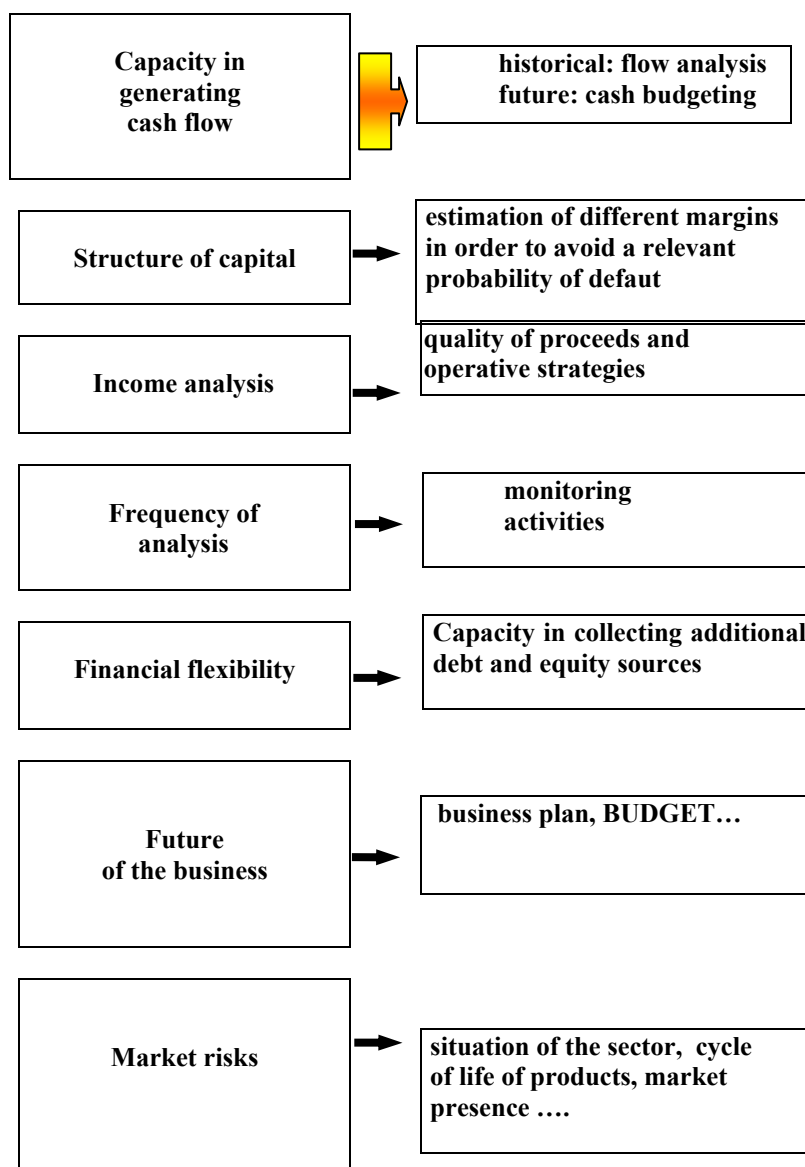
In evolved economic systems are more and more relevant typical phenomena of *new economy*; as consequence, it is possible to observe a continuous change in the characteristics of enterprises.

Comparative percentage of manufacturing activities is more and more lower<sup>(2)</sup>, and the most evolved enterprises (in any sector of activity) are engaged in advanced and high-tech services, where the competitive advantage is given by intellectual capital. The main assets of knowledge-based organisations are intangible ones, and the full value of these organisations can not be founded on the evaluation of tangible assets only (see Figure 5).



**Figure 5.** Evaluation of tangible assets of an enterprise

The banks and other professionals engaged in evaluation of enterprises have to keep a new kind of expertise in collecting and analysing quality information, and in using them properly in the estimation of rating<sup>(3)</sup> according to a rigorous procedure, as showed in Figure 6.



**Figure 6.** *The main schedules for enterprise evaluation process*

In order to employ IRB method, the banks must respect some qualitative conditions; the most important are:

- Significant differentiation of the rating systems;
- Completeness and integrity in awarding ratings;
- Caretaking on systems and processes of rating;
- Adaptation of organizing and informatic procedures;
- Internal validation;
- Trasparency and publicity.

The progressive and implementative adoption of internal rating methods represents an important chance for banks, in order to better accomplish:

- *bank discipline*: increasing the abilities in collecting, archiving and handling information; on the other hand, enterprises must have better quantity and quality of information given to banks;
- *market discipline*: transparency towards financial market and better correlation between risk management and income policy.

Banks can have big business advantages in adopting good rating methods: marketing advantages, new services opportunities, better control of risks.

From the point of view of the internal banking finance, banks can have a significant capital save: Figure 7 shows an interesting comparison between Basel 1 and Basel 2 in terms of capital take over, in relation with increasing level of credit risk (that is decreasing rating).

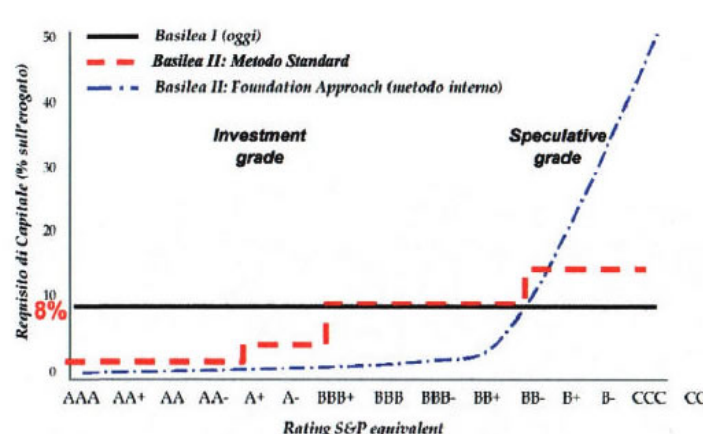


Figure 7. Capital take over evolution as a function of credit risk according Basel 1 and Basel 2

### Problem of available guarantees

The available guarantees permit a credit risk mitigation, determining a lower capital take over. This is an advantage for banks and for their clients also, in terms of possibility to reduce loan pricing.

Basel there Accord establishes:

- it can not be considered collective guarantees;
- it is necessary the periodical evaluation of goods and guarantees according with market;

- in case of personal guarantees, the guarantor rating is asked.

Table 1 details the requirements established by Basel 2.

### Conditions for credit risk mitigation established by Basel 2

Table 1

CHARACTERISTICS OF THE GUARANTEE:
<ul style="list-style-type: none"> <li>- Explicit</li> <li>- Irrevocable</li> <li>- Direct</li> <li>- Complete</li> </ul>
GUARANTOR:
<ul style="list-style-type: none"> <li>- State, Public Institution, Bank or other Financial Organisation having a better PD compared to debtor;</li> <li>- Company having rating <math>\geq</math> A (standard approach) or equivalent PD (IR foundation approach);</li> <li>- Mutual entities are not accepted</li> </ul>
PRUDENTIAL TREATMENT:
<ul style="list-style-type: none"> <li>- Corporate: principle of <i>probability default substitution</i>;</li> <li>- Retail: banks adopting IR advanced can chose if better debtor PD or reduce LGD</li> </ul>
REAL GUARANTEE: execution must be certain and timely
SIGNIFICANT CORRELATION TO DEBTOR
ACCEPTED guarantee INSTRUMENT:
<ul style="list-style-type: none"> <li>- Money on deposit in the bank giving the loan</li> <li>- Bonds with a rating at least BB- or issued by States or Public Institutions</li> <li>- Bonds issued by banks, Financial Institutions or Companies with rating <math>\Rightarrow</math> BBB-</li> <li>- Shares quoted in official markets</li> <li>- Gold</li> </ul>



**Basel 2: problems and criticalities**

Basel 2 Accord causes a lot of perplexities, troubles, criticism in banking circles, in enterprise system, in political environment too.

Beside positive purposes, some problematic collateral effects must be considered:

*1. Difficulty in collecting and handling information*

Small banks have not advanced *risk management methodologies*, so that they must adopt easier *external rating method*; as consequence they can not benefit with reduction in percentages of capital taking over.

Nevertheless, according to a simulation (QIS 3) elaborated by the Basel Committee and some banks, it should be demonstrated a minimum increase in capital taking over, because of small banks have a lot of retail clients, with a weight coefficient 75.

*2. Internal rating and SMEs*

It is possible that internal rating methods can penalize financing of SMEs, on pushing banks to reduce credits and to increase interest rate.

Internal rating methodology, based on automatized procedures (*scoring*), could be unable to take account of the various individual characteristics of SMEs, in order to estimate the correct credit risk.

Banks might take in good account that small and medium business are very useful in order to diversify and to split up the total credit risk, because their failure causes a minimum effect in the surrounding economic environment.

In order to reduce the possibility of a general indiscriminate deterioration in credit access for SMEs, Basel Committee introduces focalised factors in risk evaluation.

*3. Financial cyclicity*

This problem is very important from the point of view of macroeconomic and financial stability. According to Basel 2 prescriptions, the capital of banks can change in consequence of the economic cycle: for instance, in periods of low and critical economic activity, loans are more risky and banks are induced to increase the interest rate and to reduce credit, in order to avoid the capital rise.

For minimizing cyclical impact, Basel Committee suggest that banks estimate the probability of default of enterprises on using prudent and anticipatory criteria, and calculate the amount of capital under conditions of stress. In addition, banks are invited to forecast the credit risk during the whole economic cycle, and to save an adequate reserve in order of hedging unexpected losses.

#### 4. *Adverse selection*

Phenomena of adverse selection are possible, because of the most risky debtors could be concentrated in banks adopting external rating methods. Enterprises with a low credit risk are interested to be evaluated by banks adopting internal rating methods, in order to achieve a good rating and, as consequence, more credit and lower interest rate. On the contrary, enterprises with an high credit risk prefer banks adopting external rating methods: in the worst case it would be given a risk weight lower than a negative individual internal rating.

#### **Basel 2 and SMEs**

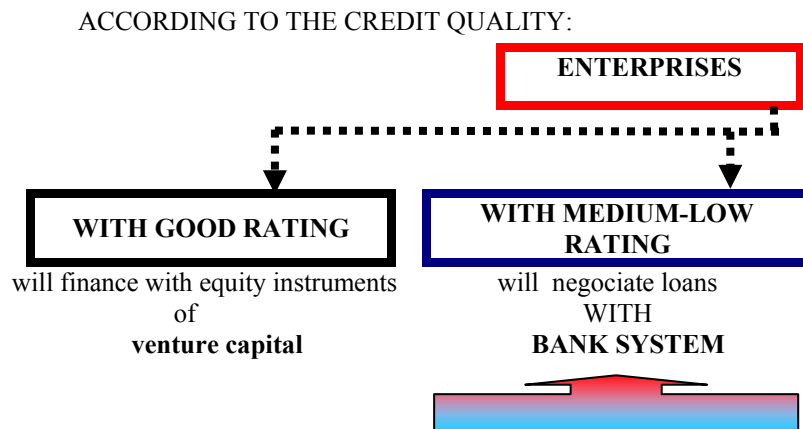
Measuring credit risk with rating methods asks the use of complex methodologies: it is necessary to identify significant factors, to weight them with right coefficients, to use mathematic models able to sintetize all the variables in a single index of rating<sup>(4)</sup>. In addition, it is preliminarily asked to collect a lot of information about enterprises.

These procedures have a negative influence on the credit access for SMEs: they are not organized in the purpose of generating and formalizing a lot of accounting and qualitative information; they are not so open-minded in giving a complete disponibility of information to banks; they are not so able in exploiting their information in order to have a good evaluation by banks.

At first, it is very important taking care of the performance trends: they are the main warning system utilized by banks in monitoring the change in financial performance of small enterprises. A bad interpretation of trends can generate a bad opinion, expecially when the enterprise is a client of several banks; in fact, any bank is unable to have a complete frame of the financial activity of enterprise.

As consequence, banks are stimulated to better their informative systems in order to increase the implementation and monitoring of internal rating methods; this is the right way for reducing problems of adverse selection. In the same time, it is predictable that financial role will be emphasized in SMEs, with big benefits in terms of financial planning, forecasting of financial needs, collecting liquidity, cash management.

It is possible to imagine that in the next future SMEs will adopt a diversified financial policy in looking for financial sources, in terms of different organisations and different intruments (Figure 8).



**Figure 8.** Organisations and instruments for determining SMEs financial policy

In order to optimize this process in relationships between enterprises and financial system, other external agents are involved:

- *Associations of enterprises* are asked to play an important role in awakening and informing entrepreneurs and managers;
- *Organisations of guarantee* have the duty to assist enterprises in supplying banks with good guaranties;
- *Professional services* must support enterprises in specialised activities and in improving the communication with financial system.

#### **SMEs can improve their rating evaluation**

According to the opinion of several economists and businessmen, Basel 2 can stimulate SMEs towards:

- *transparency and availability of balance-sheet*: rating models are based on standardized ratios and mathematic formula; data are found in balance-sheet and other accounting documents: availability of these sources is considered a prerequisite of credibility;
- *adequate capitalization*: rating procedures take big account of financial equilibrium in enterprise and an exorbitant leverage debts/own capital is considered a negative factor; so that small business will be

pushed to increase own capital in different ways: self-financing, underwriting of fresh capital by old and new partners, as private equity and venture capital organisations; best companies will ask to be quoted in official markets (Stock Exchange and similars);

- *size increasing*: model of SME considered by banks is the Anglo-Saxon one, where the average size is typically medium; as consequence micro and small enterprises might increase their dimensional weight;

- *innovative development*: traditional sectors of activity are more and more reduced and located in less developed countries; new economy is founded on knowledge-based enterprises, where intellectual capital is able to produce innovation in products, in processes, in organization, according to Schumpeter Theory.

It is not sufficient to adequate structure and management of enterprises; it is necessary to play an active role in relationship with banks, in exploiting strength points and competitive factors.

SMEs have to improve their capacity of communication and negotiation in different ways:

1. *In looking the impact of strategic choices*: strategies and consequent decisions have a significant impact on risk profile of enterprise and its capacity to be financed by external sources.

2. *In forecasting financial needs*: financial plans are very useful in relationship with banks, in order to show entity and reasons of needs; bank appreciate the effort of enterprise to control its financial sector.

3. *In playing an active role in evaluation process*: enterprise can organize procedures of self-diagnosis and implement a system of self-evaluation; these are really useful as early warning system and precocious correction of possible criticalities.

4. *In communicating to banks*: number and frequency of information is a practice well appreciated by banks; the best entrepreneurs are able in explaining to banks what they are doing and how they are managing.

5. *In understanding what is the opinion of bank about enterprise and entrepreneur*: it is important to look for the criteria used by bank in order to estimate rating and what are the best key in order to improve it.

6. *In comparing criteria of different banks*: banks use different risk models, and it is very hard to compare them; enterprise might be able

to self-estimate its probability of default and to utilize this index in order to negotiate with banks.

*It is impossible to ignore that the way towards Basel 2 rises many difficulties for small enterprises: absence in specialistic skills, minimum organization and people, essential computerization, and so on. Improvement asks a change of mentality and culture in entrepreneurs, right investments, relevant operative costs.*

*Risks about the results are high. In any case, a long time of adaptation is needed.*

*In the meantime how banks will behave under the pressure of Basel 2?*

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**Notes:**

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<sup>(1)</sup> A new approach in finding and analysing qualitative sources was studied by Pagliacci. See: Mario G.R. Pagliacci, *La politica del credito commerciale nella gestione aziendale*, FrancoAngeli, Milano, 2006.

<sup>(2)</sup> For instance, the composition of economic system in Italy can be syntesized as follow:

- Services 71%
- Manufacture 21,5%
- Buildings 5%
- Agriculture 2,5%.

<sup>(3)</sup> Some models that analyse intangible assets are used in management controlling, but they are not able to evaluate credit risk. Pagliacci-Terenziani studied an innovative methodology for estimating rating of knowledge-based enterprises: it allows to evaluate either tangible or intangible assets (Mario G.R. Pagliacci - Pamela Terenziani, *La valutazione delle imprese knowledge-based e Basilea 2*, Amministrazione &Finanza ORO, IPSOA, Milano, 2007).

<sup>(4)</sup> The most frequently used models can be grouped in four categories: linear discriminant analysis; logit/probit analysis; neural networks; expert systems.

## **ECONOMIC AND SOCIAL EVOLUTION OF ROMANIA DURING 1.I-28.II.2007 PERIOD**



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**Abstract.** *This material is analysing, on the basis of the computed indicators, the macroeconomic outcomes recorded by Romania within the first two months of the year 2007.*

*This period means actually the first segment after the adhesion moment and might be evaluated as a sign for the trend which our country is going to follow during the post-adhesion period.*

*Under the circumstances, the analysis covers the data concerning the evolution of prices, resources of prime energy, constructions, domestic trade, services, foreign trade, tourism, wage gains, labor market etc. The available data are analyzed in comparison with both the situation being recorded for the similar period of 2006 year and the previous month.*

*In general terms, there is a positive trend of the evolution of the main macroeconomic indicators which can be noted out of this analysis.*

**Key words:** trend; price; services; conjuncture; dynamic evolution.

**REL Classification:** 8A, 10B, 19I



### **A. Main macroeconomic indicators**

#### *1. Prices*

In February 2007, *consumer prices* kept almost the same level as the previous month per total, for food goods, and for non-food goods and increased by 0.4% for tariffs of services.

In the group of food goods, higher increases were registered for: vegetables and tinned vegetables (+1.7%), sugar (+1.2%) and fruit and tinned fruit (+0.8%).

The important decreases of prices in the group of food goods were for eggs (-14.7%).

For non-food goods, a significant increase of prices was registered for tobacco and cigarettes (+1.2%). In the group of non-food goods, decreases were registered by prices for fuel (-1.2%), medicines (-0.6%), cultural-sport products (-0.2%).

The evolution of tariffs for services (+0.4%) was mainly influenced by the increase in tariffs of water, sewerage, sanitation (+1.4%), car and electronic repairs, photo works (+1.4%), medical assistance (+1.1%) and hygiene and cosmetics (+1.0%).

In February 2006, *industrial production prices* kept about the same level as the previous month.

Mining and quarrying registered a decrease of prices by 3.4% as against January 2007, due to the lower prices mainly for extraction of hydrocarbons and annex services (-4.8%).

In manufacturing, for a lower growth of prices per total (+0.3%), more important growths were registered for: publishing houses, poligraphy, recording and copying (+3.3%), textile products manufacturing (+2.1%), medical precision, optical, watchmaking instruments and apparatus (+2.0%), rubber and plastic products (+1.8%), leather goods and footwear (+1.7%).

The evolution of tariffs for electric and thermal energy, gas and water (+0.1%) is given by a similar growth of tariffs by 0.1% both for production, transport and distribution of electric and thermal energy, gas and water and for water collection, treatment and distribution.

By broad industrial groups, in February 2007, as compared to January 2007, the following increases in prices were registered: 0.8% for capital goods industry group, 0.6% for current use goods industry group, 0.5% for intermediate goods industry group, 0.5% for durable goods industry group.

The prices for energy industry group products decreased by 1.4%.



## B. Sectorial evolutions

### 1. Industry

In the first two months of 2007 industrial production keeps its growth trend with over 7% registered in 2006.

#### Industrial production indices (%)

– unadjusted series –

Table 1

	February 2007 as Against:		1.I-28.II.2007 As Against 1.I-28.II.2006
	January 2007	February 2006	
<b>Industry - total</b>	<b>105,6</b>	<b>110,2</b>	<b>107,4</b>
<i>- by sections</i>			
<b>Mining and quarrying</b>	98,7	99,5	98,0
Manufacturing	107,5	112,7	109,6
Electric and thermal energy	92,5	93,5	94,2
<i>- by broad industrial groups:</i>			
Intermediate goods industry	104,8	116,1	113,7
Capital goods industry	112,9	107,0	103,8
Consumer goods industry	108,9	114,2	110,5
Durable goods industry	108,6	105,7	108,4
Current use goods industry	108,9	116,2	111,0
Energy industry	95,1	95,4	94,8

#### 1.1. Comparison with the previous month

The *industrial production* in February 2007, as against the *previous month*, registered a growth of 5.6% per total, because of the increase of production in manufacturing by 7.5%. Mining and quarrying and in electric and thermal energy, gas and water registered decreases by 1.3% and 7.5% respectively.

*Mining and quarrying* registered decreases in the branches: metalliferous ores quarrying and preparation (-56.1%) and coal mining and preparation (-2.2%).

Hidrocarbons extraction and annex services kept the same level as the previous month and in other extraction activities registered a growth by 5.1%.

In *manufacturing*, the most important growths were registered in the branches: machinery and equipment (+31.8%), construction materials manufacturing and other products of non-metallic minerals (+20.8%), pulp, paper and paper products (+18.3%), metallic construction and metal products (+15.7%), tobacco products (+15.0%), medical, precision, optical watchmaking instruments and apparatus (+14.6%) and means of transport not including road transport (+12.9%).

Higher decreases were registered in the branches: radio, TV and communication equipment (-47.7%) and petroleum, coal coking and treatment of nuclear fuels (-8.8%).

In *electric and thermal energy, gas and water*, the production, transport and distribution of electric and thermal energy, gas and water decreased as against the previous month by 7.6%, and water collection, treatment and distribution by 7.2%.

By broad industrial groups, decreases were registered in energy industry (-4.9%) and higher growth in capital goods industry (+12.9%), current use goods industry (+8.9%) and durable goods industry (+8.6%).

### **1.2. Comparison with the same month of the previous year**

In February 2007 as against February 2006 the *industrial production* registered a growth of 10.2%.

In *manufacturing*, growths were registered in most of branches, the most important ones in construction materials manufacturing and other products of non-metallic minerals (+68.7%), medical precision, optical, watchmaking, instruments and apparatus (+28.0%), textile products manufacturing (+27.7%), chemical substances and products (+26.6%), food and beverages (+23.0%), pulp, paper and paper products (+22.5%), wood and wooden products manufacturing (+22.5%) and rubber and plastic products (+21.6%). Higher decreases were registered in the branches: clothing articles (-19.5%), petroleum, coal coking and treatment of nuclear fuels (-13.9%), tobacco products (-13.1%) and publishing houses, polygraphy, recording and copying (-9.8%).

By broad industrial groups, the highest growths were registered in the current use goods industry (+16.2%) and intermediate goods industry (+16.1%).

In February 2007, *total turnover*<sup>(1)</sup> of industrial units was by 20.4% higher, as compared to February 2006, higher growths being registered in durable goods industry (+45.8%), intermediate goods industry (+34.1%), current use goods industry (+29.0%) and capital goods industry (+22.4%).

In February 2007, the *value of new orders* in manufacturing branches working based on orders was RON 11.457 million, the highest values being registered in intermediate goods industry, RON 5229 million, followed by capital goods industry, RON 2795 million, while durable goods industry registered the lowest value, respectively RON 684 million.

### 1.3. Comparison with the 1.I – 28.II.2006 period

The unadjusted series of indices, during 1.I-28.II.2007, as compared to the same period of the previous year, points out that the *industrial production* was by 7.4% higher, because of 9.6% growth for manufacturing production.

The highest growths were registered in the branches with important weights<sup>(2)</sup> of manufacturing: construction materials manufacturing and other products of non-metallic minerals (+74.3%), radio, TV and communication equipment (+50.0%), medical, precision, optical, watchmaking instruments and apparatus (+25.2%), means of transport not included in road transport (+24.3%), textile products (+22.0%), pulp, paper and paper products (+21.5%), wood and wooden products manufacturing (+21.3%), rubber and plastic products (+19.4%). The impact of significant growths over the increase of total manufacturing (+9.6%) was diminished by the falls registered in other sectors of manufacturing such as: clothing articles (-18.5%), tobacco products (-12.5%), petroleum, coal coking and treatment of nuclear fuels (-12.1%).

By broad industrial groups, the most important growths were registered in the industry of intermediate goods (+13.7%), current use goods (+11.0%) and durable goods (+8.4%).

During 1.I-28.II.2007, in comparison with the corresponding period of 2006, the growth of **turnover** per total industry was 21.8%, mostly due to the contribution of durable goods industry (+45.4%), intermediate goods industry (+37.2%), capital goods industry (+31.1%) and current use goods industry (+28.8%).

The *labour productivity in industry* registered a growth of 12.6% during 1.I-28.II.2007 as against the same period of the previous year, due to the productivity in manufacturing (+13.8%) and in mining and quarrying (+17.2%).

#### **1.4. Resources of primary energy**

During 1.I-28.II.2007, the *main resources of primary energy* amounted to 7112.4 thou tonnes equivalent<sup>(3)</sup> oil (of which 3978.7 thou tonnes equivalent oil from domestic production), decreasing by 0.5% as against the corresponding period of 2006, as a result of production's fall by 6.5%. Import of primary energy resources increased by 8.3%.

During 1.I-28.II.2007 period, the *production of electric energy* amounted to 10784.8 million kWh, decreasing by 5.9% as against 1.I-28.II.2006 period. Most of production is still obtained in thermo-power stations (71.0%), followed by hydro-power stations (19.7%).

The *final consumption of electric energy* was 8625.4 million kWh during 1.I-28.II.2007, by 0.7% higher than during 1.I-28.II.2006; public lighting decreased by 6.3% and population consumption registered a growth of 6.9%.

### **2. Construction**

In February 2007, the *construction works* registered a growth of 28.6% as against February 2006, this growth being pointed out in all the types of construction, as follows: residential buildings (+35.5%), non-residential buildings (+29.6%) and civil engineering (+26.8%).

By structure elements, the most important growths were registered for capital repair works (+34.1%) and for maintenance and current repair works (+34.0%).

In February 2007, *3169 construction permits were released for residential buildings*, by 53.1% more than in the corresponding month of 2006.

During 1.I-28.II.2007, the *value of construction works* registered a growth by 27.9% as against the same period of the previous year. By structure elements, the most important growths were registered for maintenance and current repairs works (+34.2%) and for capital repairs works (+34.0%). From the point of view of the construction type, the point of highest growth was registered for residential buildings (+34.9%).

### 3. Trade and services

#### 3.1. Comparison with the previous month

In February 2007, the turnover volume of enterprises having as main activity *retail (except trade of motor vehicles and motorcycles)* decreased by 1.9%, as against the previous month. Falls were registered for sale of non-food products (-9.7%), both for those sold by specialised shops (-16.3%) and for those sold by non-specialised shops (-6.5%).

In February 2007, the turnover volume of enterprises having as main activity *wholesale and retail, maintenance and repair of motor vehicles and motorcycles, retail of fuel for motor vehicles* was by 18.3% higher than previous month. Trade of motor vehicles registered a growth of 30.6% and retail sale of fuel a fall of 3.7%.

In February 2007, the activity of *market services rendered to the population* registered a growth by 10.1% higher than in the previous month.

For *wholesale*, in February 2007, turnover in current prices increased by RON 2878 million as compared to the previous month.

In February 2007, the *services mainly rendered to the enterprises* registered a turnover, in current prices, by RON 31 million higher as compared to the previous month.

#### 3.2. Comparison with the same month of the previous year

In February 2007, the turnover volume of enterprises having as main activity *retail (except trade of motor vehicles and motorcycles)* experienced a fall of 4.8% as against February 2006. Products sold on-line registered a growth by 0.7%.

In February 2007, the turnover volume of enterprises having as main activity *wholesale and retail, maintenance and repair of motor vehicles and motorcycles, retail of fuel for motor vehicles* registered a growth of 66.1% as against February 2006.

As regards the *retail* (including trade of motor vehicles), the turnover volume index for *small and medium-sized enterprises* was 104.6% in February 2007 as against February 2006, while for *big enterprises* having 250 employees and over this index reached 150.0%.

In February 2007, the activity of *market services rendered to the population* registered a turnover by 1.3% lower than in February 2006. Important increases were registered for the activities: of laundry, cleaning

and dying textiles and fur (+35.5%), hotels and restaurants (+34.7%), activities of travel agencies and tour-operators (+11.6%) and hairdresser and other beauty activities (+6.9%).

In February 2007, *wholesale* turnover, in current prices, increased by 71.3%, namely by RON 7131 million current prices, as against February 2006.

The *services mainly rendered to the enterprises* registered a turnover, in current prices, by 81.6% higher, namely by RON 3396 million.

### **3.3. Comparison with the 1.I – 28.II.2006 period**

During 1.I-28.II.2007, as compared to the same period of the previous year, the turnover volume of enterprises having as their main activity *retail trade (except for trade of motor vehicles and motorcycles)* registered a fall of 2.2%. Falls were particularly registered as regards the on-line marketing of products (-8.8%), this system being chosen by the population with high income and little free time.

The turnover volume of enterprises having as main activity *wholesale and retail trade, maintenance and repair of motor vehicles and motorcycles, retail trade of fuel for motor vehicles* registered a growth of 59.8% during 1.I-28.II.2007, as compared to the same period of the previous year.

As regards the *market services rendered to the population*, registered a fall of 0.6% during 1.I-28.II.2007, as against the same period of the previous year.

### **4. Foreign trade**

In January 2007, *FOB exports* amounted to RON 6682.6 million (€ 1965.4 million), their value being with 2.9% higher than in the same month of 2006, calculated from values expressed in RON, respectively 10.7% calculated based on values expressed in €.

In the structure of exports, three of the 10 sections of goods comprised in the Standard International Trade Classification (SITC Rev. 4) account for 80.2% of total exports as follows : transport machinery and equipment (32.0%), manufactured products mainly classified by raw material (24.5%) and manufactured items (23.7%).

In January 2007, *CIF imports* amounted to RON 10293.5 million (€ 3026.9 million), their value being higher than in the same month of the

previous year with 16.7% from values expressed in RON, respectively 25.4% from values expressed in euro.

In the structure of imports, three of the 10 sections of goods comprised in the Standard International Trade Classification (SITC Rev. 4) account for 73.9% of total imports, as follows: transport machinery and equipment (36.6%), manufactured products mainly classified by raw material (24.6%) and mineral fuel, lubricants and connected materials (12.7%).

In January 2007, the trade deficit was RON 3610.9 million (€ 1061.5 million) in FOB/CIF prices.

Value of intracommunity exchanges of goods in January 2007 was RON 4896.3 million (€ 1442.8 million) for deliveries and RON 7303.0 million (€ 2152.0 million) for inputs representing 73.3% of total exports respectively 71.0% of total imports.

## **5. Tourism**

### **5.1. Comparison with the same month of the previous year**

In February 2007, as compared to February 2006, the *arrivals in establishments of tourist reception with functions of tourist accommodation* were by 8.5% higher.

The *overnights in establishments of tourist reception with functions of tourist accommodation* decreased in February 2007 by 4.8% as against February 2006.

In February 2007, the *index of net use of accommodation places* was 27.1% per total establishments of tourist reception with tourist accommodation functions as against 28.4% in February 2006. The highest value of this index was registered in hotels (31.5%). By touristic areas, the highest index was for, "Danube Delta area, including town of Tulcea".

In February 2007, the *foreign visitors' arrivals in Romania* registered at the borders increased by 8.7% as against February 2006. Most of foreign visitors come from European countries (94.8%); 61.0% of total foreign visitors arrivals in Romania come from EU countries.

In February 2007, the *Romanian visitors' departures abroad* registered at the borders increased by 16.6% as compared to February 2006. Road transport means were mostly used by Romanian visitors for departures abroad (80.2% of total departures).

### **5.2. Comparison with the 1.I–28.II.2006 period**

During 1.I.-28.II.2007, in comparison with the same period of the previous year, *the arrivals in the establishments of tourist reception with functions of tourist accommodation* were by 8.5% higher.

*The overnights in establishments of tourist reception with functions of tourist accommodation* experienced a 1.4% increase during 1.I.-28.II.2007, as against the same period of the previous year.

During 1.I.-28.II.2007, the *index of net use of accommodation places* was 24.4% per total establishments of tourist reception with functions of tourist accommodation, similar to 1.I.-28.II.2006 period. The highest value of this index was registered in hotels (28.5%). By touristic areas, the highest value of this index was for Bucharest and towns-county residence, except Tulcea.

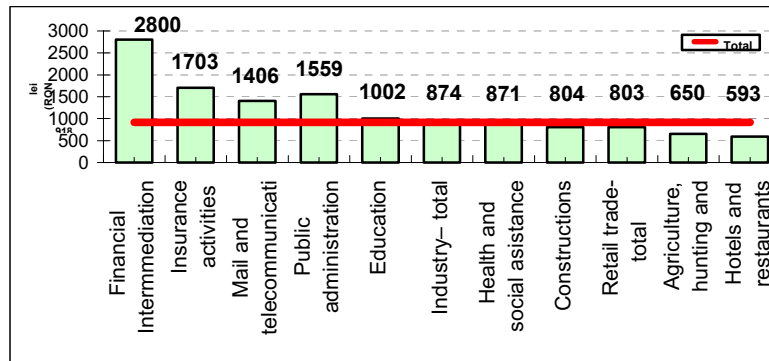
During 1.I.-28.II.2007, the *foreign visitors' arrivals in Romania* increased by 4.6% as against the corresponding period of previous year. Most of foreign visitors come from European countries (94.3%). 61.3% of total foreign visitors arrivals in Romania come from EU countries.

During 1.I.-28.II.2007, the *Romanian visitors' departures abroad* increased by 14.2%, as against the 1.I.-28.II.2006 period. Road transport means were mostly used by Romanian visitors for departures abroad (79.2% of total departures).

### **6. Earnings**

In February 2007, the *gross nominal average earning* per total economy was RON 1264 and the net one was RON 941, increasing as against the previous month by 2.6% and 2.5% respectively.



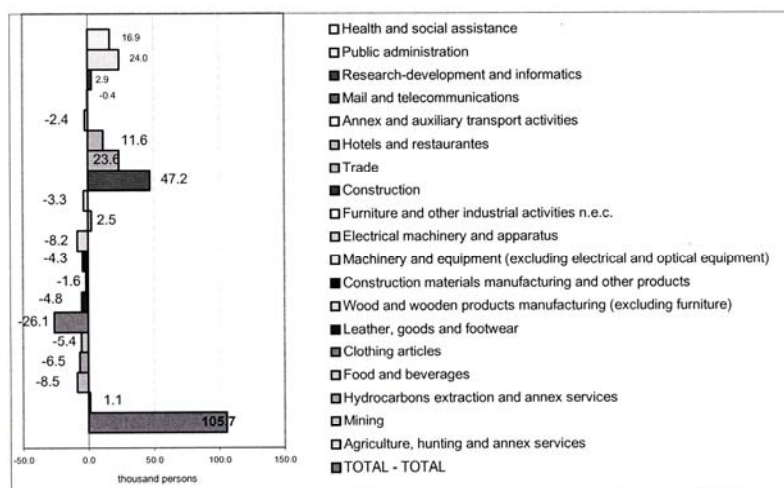


**Figure 1.** Net average earnings in February 2007 by main economic activities

In February 2007, the ratio between the net nominal average earning index and the consumer price index was 102.5% in comparison with the previous month, 118.2% as compared to the same month of 2006 and 99.6% in comparison with October 1990.

### 7. Labour force market

The number of employees (of the units having 4 employees and over) amounted to 4671.3 thousand persons in February 2007, by 24.3 thousands more than in January 2007.



**Figure 2.** Differences of employees' number in February 2007 as against February 2006

### 8. Unemployment

According to the data provided by the National Agency for Employment, the *number of registered unemployed* at the end of February 2007 was 459.0 thousand persons. In comparison with February 2006, the number of unemployed registered at the agencies for employment was by 95.6 thousands lower. Of total number of registered unemployed, women represented 40.7%.

The *unemployment rate registered* in February 2007 was 5.2% as against the total civil active population (6.2% in February 2006). Female unemployment rate was by 1.3 percentage points lower than male unemployment rate (4.5% as against 5.8%).

High unemployment rates were registered in the counties: Mehedinți (10.5%), Vaslui (10.1%), Teleorman (8.3%), Ialomița (8.1%). The lowest unemployment rates were registered in the counties: Ilfov (1.9%), Timiș (2.0%), Bihor (2.8%) and Bucharest Municipality (2.3%).

### C. Short-term indicators

According to the estimations made in March 2007 by the managers of companies, for the next three months, in comparison with the previous months, a growth of activity in manufacturing, construction and retail and the same positive trend in the sector of services are expected.

For March-May 2007 period, the managers of *manufacturing* enterprises estimate a growth of production volume (short-term balance +25%). The number of employees per total manufacturing will register a stability trend (short-term balance -2%). Prices of industrial products will register a growth in the next period too (short-term balance +18%).

According to March 2007 estimations, in the *construction* activity, an upward trend of production volume is forecast in the next three months (short-term balance +46%). A upward trend (short-term balance +20%) is also expected as regards the number of employees. Prices of construction works will rise (short-term balance +34%).

For March-May 2007 period, the managers of *trade companies* estimate a growth of goods' sales per total activity (short-term balance +37%). For the next three months, employers foresee a growth in the number of employees (short-term balance +12%). Retail selling prices will further increase in the next three months (short-term balance +33%).

According to March 2007 estimations, the demand of *services* will continue to experience an upward trend in the next three months too (short-term balance +24%). For March-May 2007, the surveyed persons who work in this field forecast an increase in the number of employees (short-term balance +15%). In the managers' opinion, the costs for provisions of services will register an upward evolution (short-term balance +33%).

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#### Notes:

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- <sup>(1)</sup> Total turnover comes both from total activity and from secondary activities of industrial type enterprises.
- <sup>(2)</sup> Weights established based on the gross value added at factor cost (GVAFC) of the base year (2000).
- <sup>(3)</sup> Conventional fuel with caloric power of 10000 kcal/kg.

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## ROMANIA'S REAL CONVERGENCE TO EU - DREAM OR REALITY?

■

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**Abstract.** *In transition, the Romanian authorities have advanced the development of prudent macroeconomics policies and implemented structural reforms in the market for goods, labor and financial products. On the long term, Romanian real convergence to the European model is more important than nominal convergence. In this paper, we identify the main priorities for the success of Romanian admittance in European Union. The nominal convergence must be attained faster because this process supposes stability prices, the financial soundness indicators, the need to stabilize exchange rate. In addition, the real convergence with European Union is very important.*

**Keywords:** convergence; nominal convergence; real convergence; structural convergence.

**REL Classification:** 8M, 19I, 20G

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Is known as the process of nominal convergence entails achieving macroeconomic targets easier to reach than the corresponding real convergence. Including achieving standards related to infrastructure, human capital, education and proper structure of the economy, real convergence is actually quintessentially of European economic integration.

The real convergence with the European model can be analyzed through two assumptions. The first perspective supposes analysis of real convergence through income convergence; productivity convergence; relative prices convergence; employment structure convergence; educational convergence. The second perspective assumes that real convergence criteria and the conditions regarding admittance into Optimum Currency Area are equal. Higher openness degree of economy, business cycle synchronization with the EU, labor force mobility, a higher degree of financial intermediation and the higher flexibility of wages and prices lead to the faster catching-up process. In this paper, we focus on the first approach of real convergence.

The analysis of the real convergence process is not official in EU. In fact, European Commission avoided imposing strict criteria as the nominal convergence criteria. However, there were authors which tried to establish the quantitative criteria regarding the measurement of real convergence. Hen and Leonard (2003) consider four criteria that quantify this process: growth of GDP ( $\pm 2\%$  around the average of three best performing member states in this process); unemployment ( $\pm 3\%$  around the average of three best performing member states in this process); surplus/deficit of the current account balance (around  $\pm 2\%$  to GDP) and competitiveness indicator vis-a-vis Germany (around  $\pm 10\%$  at the begin of implementing euro to the market).

Isărescu, M. (2004) considers that the real convergence process can be analysed by following criteria: openness degree of economy (exports + imports/GDP); weight of bilateral commerce to the EU countries in total commerce; GDP per capita (at purchasing parity power) and the structure of economy.

Regarding the analysis about GDP per capita at purchasing parity power, the Romanian real convergence with European countries is low - Romania was 34% relative to the EU-27 average, less than Czech Republic (75%), Poland (51%), Hungary (63%), Slovenia (83%), above Bulgaria (33%).

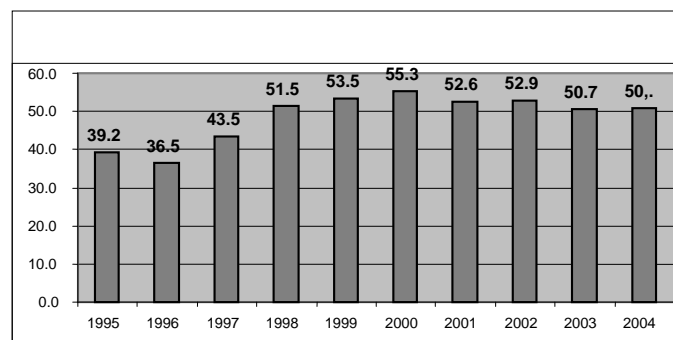
**GDP per capita at purchasing power parity (PPP)**  
(EU-27 average = 100)

Table 1

Country/Years	2003	2004	2005	2006	2007 (estimation)	2008 (estimation)
Bulgaria	29.7	30.6	32.1	33.3	35.5	37.0
Czech Republic	67.8	70.3	73.3	75.0	78.1	80.0
Poland	47.0	48.8	49.8	51.0	52.4	53.8
Romania	30.0	32.2	32.9	34.2	37.0	38.4
Hungary	59.3	60.1	61.9	63.2	63.7	64.2
Greece	81.1	82.0	83.6	84.7	85.7	86.8
Spain	97.4	97.6	98.3	98.2	97.8	98.3
Portugal	72.8	72.4	71.2	70.0	68.8	68.1
Italy	107.8	105.8	103.6	103.1	98.6	97.7
EU-15/EU-27	100	100	100	100	100	100

Source: EUROSTAT, 2007.

Although there has been a relative stability of the structure of the Romanian economy, economic sector analysis reveals division lowest structural convergence towards the EU average of ex-communist countries 50,8%, while the average of ECE countries was 75%, and Bulgaria has 68%.



Source: Eurostat, 2005.

**Figure 1.** Structural convergence index of Romanian economy relative to EU-15

The forecasts about dynamics of Romanian economy structure in the next three years are the pessimistic ones. National Commission of Prognosis (NCP) shows that in 2006-2008 the structure of Romanian economy will be the same. In 2008, the structural convergence indicator will be 55,3% relative to average EU-27. The structural divergence can grow if the services contribution to the EU-27 GDP increases.

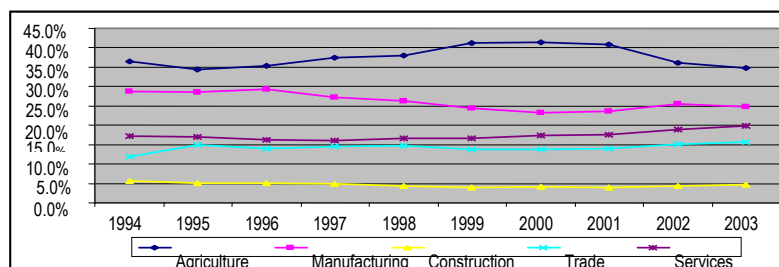
**Estimation of added value at the sector level in Romania**  
(2006-2008)

Table 2

	2006	2007	2008
Manufacturing	31.1%	31.4%	31.5%
Agriculture	12.8%	12.3%	11.7%
Construction	7.2%	7.5%	7.8%
Services	48.8%	49.0%	49.0%

**Source:** National Commission of Prognosis, 2005.

Romanian employment index for the convergence to the EU-15 shows a great divergence between the ECE and EU-15 countries (26,05% in Romania versus 65-70% in EU-27).



**Source:** INSSE, 2004.

**Figure 2.** *Employment degree at the sector level in Romania*

Also, Romania has a structural problem regarding the energy intensity of the economy (the energy consumption to GDP).

Romania produces with higher energy consumption, 6,5 times higher than EU average.



**Energy intensity of the economy**

(energy consumption - % GDP, in constant prices 1995=100,  
kgoe – kilo to oil equivalent, per 1000 euro)

Table 3

Country/Years	2001	2002	2003
Bulgaria	1930	1804	1756
Czech Republic	884	876	890
Poland	674	654	663
Romania	1368	1316	1368
Hungary	589	580	582
Greece	261	258	250
Spain	225	226	227
Portugal	244	255	251
Italy	184	184	192
EU-15/EU-27	210	207	210

Source: EUROSTAT, INSSE, 2007.

**Labor productivity per person employed**

(GDP at purchasing power parity per person employed person, relative to  
EU-27 = 100)

Table 4

Country/Years	2003	2004	2005	2006	2007 (estimation)	2008 (estimation)
Bulgaria	31,9	31,7	32,6	33,6	36,3	37,7
Czech Republic	62.0	64.3	68.6	70.4	72.3	73.4
Poland	59.6	62.0	62.7	63.8	60.4	61.9
Romania	34.0	36.3	36.6	37.9	42.5	44.2
Hungary	66.8	68.1	70.1	71.6	73.7	74.5
Greece	100.5	98.2	97.5	101.1	103.0	104.0
Spain	99.9	99.1	97.9	95.3	94.9	93.8
Portugal	66.0	65.8	65.2	64.8	64.6	64.3
Italy	111.7	110.3	108.8	108.3	104.1	103.3
EU15/EU27	100	100	100	100	100	100

Source: EUROSTAT, INSSE, 2007.

Economic theory postulates indicate a high correlation between increasing labor productivity and capital endowment companies, mainly through investments.

**Business investment**  
(as a percentage of GDP)

*Table 5*

Country/Years	2002	2003	2004	2005	2006 (estimation)
Bulgaria	15,3	16,5	17,7	17,9	18,4
Czech Republic	22,9	22,7	22,6	20,0	24,2
Poland	15,3	14,9	14,6	14,8	16,8
Romania	18,3	18,6	18,6	18,2	19,9
Hungary	18,3	18,8	19,3	18,7	21,4
Greece	20,0	21,3	21,1	20,2	23,4
Spain	22,7	23,5	24,5	25,8	28,6
Portugal	21,6	19,4	19,2	19,1	19,2
Italy	19,1	17,8	18,1	18,2	19,1
EU-15/EU-27	17,2	16,9	17,1	17,4	18,2

**Source:** EUROSTAT, INSSE, 2007.

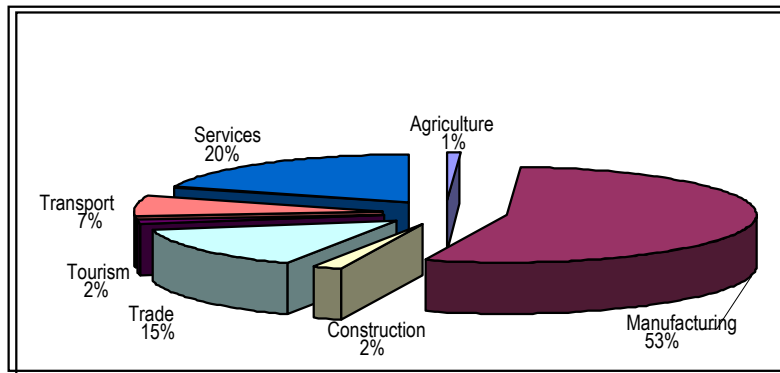
The high percentage of business investment in GDP for Romania offers the prospect of future productivity gains through greater intensity of labor with capital endowment.

Many structural problems of the Romanian economy can be solved by stimulating virtuous circles between attracting foreign investment and industrial sector development between technological endowment and stimulating high value added in industry, all of which are prerequisites for reducing macroeconomic volatility.

In the first years of transition, the slow progress in the reform of the public sector and the overly volatile legislative framework eroded the credibility of the Romanian economy and kept foreign investors away. Accordingly, FDI remained below its potential level, with inflows derived mainly from the privatization process.

From 1990 to 2006 the largest foreign investments were attracted from the Netherlands, Austria, Germany, France and Italy, which together accounted for around 60 % of total FDI stock. In terms of sector attractiveness, most of the FDI was directed toward banking,

construction, telecommunications, retail distribution networks, the manufacture of transport vehicles and spare parts, as well as to strategic areas such as the energy and oil sectors. The business environment is very favorable and is characterized by having one of the lowest corporate tax levels in the region (16 %), a flexible labor market (despite some rigidity introduced recently by the new labor code) and labor costs that are still relatively low (Unicredit Group, 2007).



Source: INSSE, 2006.

**Figure 3.** *FDI structure in Romania*

Since 2004, Romania has become one of the most important beneficiaries of FDI in the region. While at the end of the last decade it accounted for around 5% of total FDI targeting the CEE region, from 2003 to 2005 this figure has more than tripled, reaching roughly 15 % of total FDI directed to CEE. 2006 has been a record year in this respect: according to Central Bank data, FDI surged by 75% in comparison with the previous year, reaching EUR 9.1 bn (9.8% of GDP – including the EUR 2.2 billion paid by Erste Bank for its 36.8% ownership stake in CBR).

**FDI impact to economic growth in 2005***Table 6*

	Real GDP growth	Labor contribution	FDI contribution	Internal investments contribution	Total factor productivity
Romania	1,5	0,1	6,6	-1,6	-3,7
Poland	4,5	0,7	3,5	0,5	-0,3
Bulgaria	1,1	-0,3	2,7	-1,6	0,2
Hungary	3,5	0,1	2,0	1,2	0,1
Estonia	4,4	-0,7	1	-0,2	4,1
Czech Republic	2,2	0,4	0,8	-0,4	1,4
Slovakia	4,3	0,8	0,9	-0,1	2,6
Slovenia	4,1	0,1	0,3	0,4	3,2
Latvia	4,5	-0,6	2,4	0,7	1,8

**Source:** Deutsche Bank, 2005.

Romania has one of the highest GDP per capita average growth rates in the region (about 10% annually during 2000-2005 at PPP), overfulfilled only by Estonia. Despite this evolution, we still had the lowest level of GDP per capita in 2005 relative to the other EU members used for benchmarking, excepting Bulgaria. GDP increased even faster in 2004-2006 than earlier. In 2004, GDP growth was 8,4%, one of the highest in Europe.

Romanian's economy modernization supposes a developement infrastructure. We need roads, telecommunications network, extension of financial intermediation services, public utilities etc. With only 211 km of highways, Romania is far behind Hungary or Poland and this puts a significant upward pressure on infrastructure and transportation costs. Relative to country's surface, Romania has the lowest road network from EU-27 countries, 41 times lower than in Germany.

**Length of road network**

Table 7

Country	Kilometres
Germany	9.000
France	7.800
Italy	6.800
Spain	2.700
Hungary	350
Bulgaria	290
Croatia	260
Slovakia	257
Romania	211

Source: Eurostat, 2007.

As a recipient country structural and cohesion funds totaling over 19 billion euros, Romania will have full use of this source of funding for infrastructure gap.

However, with an absorption rate of only 4 %, well below the average of other countries in our cluster, Romania will not be able to fully spend this money, risking fate of the EU average emphasizing gaps. .

**Absorption capacity of European Funds in the period  
2000-2006**

Table 8

Country	Absorption capacity (% relative to commitments)
Ireland	74%
Austria	68%
Spain	67%
Germany	64%
Belgium	58%
France	56%
Italy	52%
Greece	40%
Slovenia	28%
Latvia	24%
Lithuania	24%
Hungary	23%

Country	Absorption capacity (% relative to commitments)
Slovakia	23%
Poland	20%
Czech Republic	18%
Bulgaria	7%*
Romania	4%*

\* 2007 estimation **Source:** Eurostat, 2006.

Otherwise, we must say that in Romania the price level convergence speed relative to average price level of EU-27 (52% in 2006) is faster than salary convergence increase relative to EU-27 average (10,2%). In Romania (2004), gross average salary is only 271 Euro, 10 times lower than in UE-27 (2888 Euro). It is worrisome behavioral asymmetry between income and price convergence convergence .

**Price convergence versus gross average income**  
(Romania relative to EU-27)

*Table 9*

Country/Years	Price convergence 2004	Gross average income convergence 2004		Price convergence 2005	Gross average income convergence 2005	
	%	euro	%	%	euro	%
EU-15/EU-27	100	2935	100	100	3215	100
Romania	44	271	9,2	53	362	11,2
Bulgaria	41	213	7,2	43	284	8,8
Czech Republic	55	841	28,6	58	1022	31,8
Poland	53	699	23,8	60	876	27,2
Hungary	61	838	28,5	62	994	30,9
Greece	86	2040	69,5	87	2120	65,9
Spain	90	2081	70,9	92	2210	68,8
Portugal	86	1394	47,5	86	1593	49,5
Italy	104	3100	105	105	3423	106,4

**Source:** author's calculus, EUROSTAT, 2006.

### Conclusions

The priorities of Romania's Convergence Strategy follow closely the next characteristics: development higher value-added activities; increased energy efficiency and sustainable development of the energy system; growth absorption capacity of European funds to stimulate the investments in research, technological development, innovation and competitiveness; efficient use of European funds for improving business infrastructure, more and better jobs and the knowledge economy.

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### Note

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This paper was presented during the Symposium AGER Romania and Integration in the European Union. Opportunities and Challenges and includes the same approach to the analysis of real and nominal convergence with the EU Romania present in previous works.

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## THE BANKING SYSTEM AND INTEGRATION CHALLENGES



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**Abstract.** *This material is presenting the banking system in Romania, as it developed after 1990 year.*

*First of all, the text is pointing out the legislative framework set up for regulating the banking system, both during the transition period and just before the moment of the adhesion of Romania to the European Union.*

*Afterwards, there are several points of view being expressed as to the banking regulations, the penetration of the foreign capital in our country, the main privatizations of the former state-owned banks – BCR, BRD, BANCA AGRICOLĂ, BANCPOST etc., or the establishment of new commercial banks, of individual personality.*

*The credit institutions are analyzed from the point of view of their ownership form. A significant place is allocated to the evolution of the assets and liabilities within the banking system and the credit institutions system.*

*There are evaluations as regards the procedures of supervising the banking system, the banks distribution network and the efficiency of the commercial banking system, which are emphasized by the analysis.*

*The final part of the material is focusing on the evaluation of the Romanian banking system in comparison with the banking system of the countries members of the European Union.*

**Key words:** banking system; commercial bank; banking efficiency; interest; credit institution.

**REL Classification:** 8A, 11C, 20G



In its current organizational structure, after 17 years, the Romanian banking system is a stable and consolidated segment, as a consequence of

a lengthy restructuring process and an advanced stage of the privatization process.

After 1990, the banking system has been subject to some radical measures, being reset into two hierarchical levels: the Romanian National Bank (BNR), on the one hand, and the commercial banks, on the other hand.

BNR took over its responsibilities as a central bank, while its commercial activities were transferred to the newly founded Romanian Commercial Bank (BCR). The central bank assumed its normal functions: setting up the monetary policy, currency, credit and payment policy, as well as prudential authorization and supervision of the banking system, within the general state policy.

According to Act no. 312 / 2004 on the status of the Romanian National Bank, its main functions are:

- a) setting up and enforcing the monetary policy and the exchange policy;
- b) the prudential authorization, regulation and supervision of the credit institutions, promoting and monitoring the good functioning of the payment systems by ensuring financial stability;
- c) issuing banknotes and coins as the legal means of payment within the Romanian territory;
- d) establishing the currency regulations and supervising their lawful enforcement;
- e) administrating Romania's international reserves.

Based on these functions, the National Bank will play a major part in supporting the general state policy, by supervising the normal functioning of commercial banks and contributing to the promotion of a financial system specific to the market economy.

We have witnessed a vast process over the last years: a growing number of banks have appeared and disappeared, as part of a selection process, during which many of the newly founded credit institutions could not cope with the subsequent demands.

The former state-owned banks have been turned into commercial banks, some private capital banks have been set up and the subsidiaries of foreign banks have been integrated into domestic banking. The number of banks has grown rapidly from only 4 commercial banks in 1989 to 45 in 1998 and it stabilized to 38 in 2006. Over this period of time, many important events have shaped the structure of the banking system. Banks have had to work in an unfavorable economic environment and led by management teams which, in many cases, were not prepared to cope with the challenges of the time.

The large majority of bank operators were inexperienced and lacked adequate risk strategies. Their market shares were rather limited, the corporate activity prevailed in the banks' balance sheets, the retail activity was pretty weak and the investment funds were far from reaching their purpose, being a disappointment to investors. The effects were damaging for many banks.

*Bank regulations* have undergone a long improvement process until they finally came to set the rules of the market. The Romanian National Bank initiated a restructuring program for the banking system, which was meant to limit the system risk. Among the steps taken by the Romanian National Bank, a few are worth mentioning:

- solving the situation of the problem banks;
- reinforcing the regulations for the banks' prudential supervision;
- setting up institutions whose purpose was to directly support the banking system: the Banking Risk Office, the Payment Incidents Office, the Deposit Guarantee Fund.

Regarding the situation of the problem banks, a set of important measures is worth mentioning: authorization withdrawal and starting up bankruptcy procedures.

Between 1999 and 2003, 9 banks left the system:

1999 – authorization withdrawal for Albina Bank and Bancorex, taken over by BCR;

starting up bankruptcy procedures for Albina Bank.

2000 – authorization withdrawal for Columna Bank, Bankcoop and the International Bank of Religions (BIR);

– starting up bankruptcy procedures for Bankcoop and Credit Bank.

2002 – authorization withdrawal for the Romanian Discount Bank (BRS), the Bank for Investment and Development (BID) and BTR;

– starting up bankruptcy procedures for BIR, BRS, BTR.

2003 – starting up bankruptcy procedures for Columna Bank.

2001 – authorization withdrawal for Albina Bank and Bancorex, taken over by BCR;

starting up bankruptcy procedures for Albina Bank.

2002 – authorization withdrawal for Columna Bank, Bankcoop and the International Bank of Religions (BIR);

– starting up bankruptcy procedures for Bankcoop and Credit

Bank.
2002 – authorization withdrawal for the Romanian Discount Bank (BRS), the Bank for Investment and Development (BID) and BTR; – starting up bankruptcy procedures for BIR, BRS, BTR.
2003 – starting up bankruptcy procedures for Columna Bank.

The restructuring process has had positive effects on the banking system: the banks' agency role is exerted in good conditions and the security of the bank depositors is being consolidated.

Considerable progress is being made in the field of bank regulations: the application of a more advanced bank rating system, more severe penalty rules and criteria for bank shareholders and managers, by means of a new regulation of the bank survey period (1 year).

The Romanian legislation adopted immediately after 1989, especially Act no. 33 on bank activity and Act no. 34 on the status of the Romanian National Bank, which came into force on May 3<sup>rd</sup> 1991 (last updated in 2004 and 2006, respectively) actually set down the organization of the banking system according to the principles of the market economy and favor the development of private banks and the free penetration of foreign financial institutions on the Romanian bank market.

*The massive penetration of foreign capital on the Romanian market* is the most relevant phenomenon of the latest years in the banking system.

The 4 most important Romanian banks (in the order of their privatization) have been taken over by the foreign capital represented by prestigious international banks.

*BRD* was taken over in December 1998 by the French bank Société Générale, for a majority shareholding of 51%, amounting to the value of 200 million dollars. Only 138 million dollars of this sum was paid to the state authorities. At present, Société Générale owns 58.2% of the BRD shares, the rest of them being owned by BERD, Financial Investment Funds (SIFs) and minority shareholders.

*Bancpost* was privatized in the first trimester of 1999, when General Electric Capital Corporation and Banco Portugues do Investimento purchased 45% of the bank shares for 92.8 million dollars. EFG Eurobank Ergasias of Greece purchased shares from the two investors in several stages, finally reaching a majority shareholding of 62.74% of the Bancpost capital.

The *Agricultural Bank* (Banca Agricola) was taken over by a consortium made up of the Romanian-American Investment Fund and

Raiffeisen Zentral Bank of Austria for 52 million dollars. The consortium became the majority shareholder with over 98% of the bank's capital. The bank subsequently changed its name into Raiffeisen Banca Agricola and since 2002 it has been known as Raiffeisen Bank Romania.

BCR – the latest major bank deal not only for Romania, but for the entire Eastern and Central Europe – was earned by the Austrian bank Erste Bank, which bid the sum of 3.76 billion euro for a majority shareholding of 62%. The competition for BCR was extremely tight and nine banks were allowed to take part in the privatization process: Fortis, Millenium-BCP, the National Bank of Greece, Intesa Bank, Deutsche Bank AG, Erste Bank AG, Dexia, KBC, BNP Paribas.

It has been a record from all points of view:

- the competition: 9 major international banks were admitted in due diligence for the takeover of BCR;
- the price offered: 3.76 billion euro, which confirms the 6 billion euro value of the bank.

The privatization of BCR was finalized and recorded as such on the 21<sup>st</sup> of October 2006, although the deed of conveyance had been signed on the 21<sup>st</sup> of December 2005. The privatization process represented a follow-up of a previous stage, when 25% of the bank shares had been transferred to BERD and IFC and 8% were passed on to the bank employees. The new shareholding of the largest Romanian commercial bank is made up of: Erste Bank (61.88%), Financial Investment Funds (SIFs) (30.12%) and staff (8%).

The new BCR shareholding has been further modified by the offer made by Erste Bank to the staff for the purchase of their shares. Consequently, Erste Bank succeeded in buying a large part of the staff shares, thus raising its share quota to 69.1480%. The rest of the shareholders – besides Erste Bank and the SIFs – own only 0.7344%.

The privatization of BCR is considered without a doubt the event of the year 2006 on the banking market, because it brought about a major change in the shareholding structure of the Romanian banking system. The event was recorded in 2006, but we can actually consider it the most important moment in the entire history of the Romanian banking system.

*As a consequence, the structure of the banking system according to ownership has radically changed.*

**The structure of the credit institutions according to ownership***Table 1*

	19 98	2006	1998	2006	2005	2006
	Number		Assets			
			bn ROL	bn ROL	%	%
Credit institutions	45	39	13,328	174,742	100.0	100.0
• Banks	45	38	13,328	172,202	100.0	99.7
- State-owned capital	7	2	9,465	9,392	71.0	5.4
- Domestic private capital	13	3	1,204	10,225	9.0	5.9
- Foreign private capital, of which:	16	33	2,659	152,581	20.0	88.3
- <i>Foreign branches</i>	9	6	758	10,071	5.7	5.8
• CreditCoop	-	1	-	540	-	0.3

**Source of data:** *Romanian Banking Sector.*

- The year 1998 is considered a turning point, because at that moment the number of commercial banks was the highest – 45, as compared to 38 in 2006.

- State-owned banks lost a lot of ground, from 71% in 1998 to 5.4 in 2006, while private banks rose from 29% in 1998 to 94.2% in 2006.

- In 1998, foreign private banks owned 20% of the banking system assets and they reached 88.3% in 2006.

- The most significant change is nevertheless the transfer of state-owned banks into the category of foreign capital banks. At the end of 2006, this category of banks gained 68.3% (as compared to 1998) of the assets of the Romanian banking system. At present, Romanian banks own a very low percentage, of only 11.3%.

The transfer of property towards the foreign capital and the development of commercial banking have been reflected by the dynamics of the assets recorded over the last 8 years.

**The evolution of the banking system assets, according to ownership**

Table 2

million RON	1998	2006	2006 / 1998 %
Credit Institutions	13,328	174,742	+ 13 times
Banks:	13,328	172,202	+ 13 times
- State-owned capital	9,645	9,396	97.3%
- Domestic private capital	1,204	10,225	+ 9 times
- Foreign private capital, of which:	2,659	152,581	+ 57 times
Foreign branches	758	10,071	+ 13 times
CreditCoop	-	540	-

Source: BNR.

- Over this period of time, banks have increased their assets 13 times, with a different evolution depending on the form of ownership.

- The greatest influence has been recorded by the state-owned banks and the foreign banks. As a result of the privatization process, in 2006 state-owned banks have fewer assets than in 1998. The growth rate of the assets was insignificant in comparison with the transfer of some banks into the category of foreign capital banks. As a result of two factors – business development and the takeover of some privatized state-owned banks – foreign capital banks have also grown 57 times over the last 8 years.

All these transformations and changes have positively influenced the banking system, which, at the end of 2006, recorded its highest general performance after 1990.

Several factors have contributed to the prosperity of the banking system, influenced by steady economic growth. Four of these factors are worth mentioning for having played a major part in the process:

- The increased quality of bank management, with a good perception of risk factors;
- An appropriate capitalization and the banks' concern for the continuous improvement of this indicator;
- The regulations of the central bank are well-structured and tend to closely follow the rigorous demands of the European Union;
- The impact of big international banks on the Romanian market made a major difference, especially through their *know-how* contribution and their impact on their national customers, who are increasingly present in Romania.

According to their specific activity, universal banks prevail among the banking operators. Only 6 banks have a specialized activity:

- 3 banks that function according to special laws and regulations (Raiffeisen Housing Bank, HVB Housing Bank and Eximbank);
- 2 banks showing a marked preference for a special type of credits – although they are authorized to offer the entire range of products and services (Porsche Bank and ProCredit Bank);
- CEC, whose activity is oriented towards retail operations and which offers a full guarantee on individual deposits.

In 2006, the Romanian banking system recorded two significant events: the takeover of BCR by the Erste Bank (which – as already mentioned above - represents the main event of the year) and the HVB - Tiriatic Bank merger, another important event which places the new bank on a 4<sup>th</sup> place in the top of commercial banks.

It is quite possible that the banking system records new challenges as a result of the steps taken by the Fortis Group and by Millenium BCP in order to enter the market, both of them being already quite advanced from the point of view of the legal procedures and the team establishment, to which there are another 26 foreign banks to be added, as they have been notified the RNB about their intentions to supply financial services on a direct basis (European passport).

*The evolution of the commercial banks by the end of 2006 is reflected by the balance sheet actives and passives as well as by the dynamics and the structure of the Romanian banks operations.*

#### **The evolution of the credit institutions actives**

*Table 3*

	<b>2005</b>	<b>2006</b>	<b>2006/2005 %</b>
Total assets, of which:	130,272.6	175,460.1	34.7
External assets, of which:	4,520.3	4,635.4	2.5
- deposits in foreign banks	2,796.4	2,991.1	7.0
Internal assets, of which:	125,752.3	170,824.7	35.8
- Cash	1,346.7	2,226.5	65.3
- Non-government credit	60,672.8	93,283.4	53.7
* Retail credit	21,370.8	39,271.1	83.8
* Corporate credit	39,302.0	54,012.2	37.4
- Government credit	2,547.7	2,812.9	10.4
- Inter-banks assets	52,117.0	61,303.8	17.6
- Other assets	9,068.2	11,198.0	23.5

**Source:** RNB.



In 2006, the banks assets recorded an increase of 34.7% basically sustained by the internal assets (35.8%), while the external assets kept almost a stand-by position.

The main tendency of the commercial banks in 2006 consisted of the concentration of placements on two major positions: credits and bank deposits, mainly with the RNB.

The ratio credits/assets increased as a result of the more accelerated dynamics of the credits, from 46.5% in 2005 up to 53.2% in 2006.

The placements in equities which, during the previous years, recorded a significant position within the commercial banks balance sheet get substantially diminished in 2006, due to the fact that all forecasted issues of state equities have been cancelled.

The retail credit was the most dynamic segment, recording an increase of 83.8% while the corporate credit increased by 37.4% only.

The non-government credit evolution shows some extreme dynamics in 2006, meaning evolutions of particular dynamics such as: the long term loans 130%, the retail credit in free currency on short term 167% and the retail credit in lei on long term 280%, along with credits characterized by more moderate dynamics: the corporate credit in free currency 18.3%, the non-government credit on medium term 15.6% and the retail credit on medium term 13.2%.

The macroeconomic and regulating context, applying to the evolution of the commercial banks, implied certain characteristics to the crediting activity, at least 3 of them being of a particular relevance:

- The consumption credit is becoming, for the first time, the major contributor to the increase of the non-government credit;
- The weight of the credit on long term, as structure of financing the retail clients, is increasing to 61.1% (against 42.2% the previous year);
- The ratio credits/deposits is increasing as a result of a more determined orientation towards the placements of higher yields (96.6% in 2006 against 81/0% in 2005). As far as the national currency is concerned, this ratio is even better, 75.6% (44.6% the previous year). The indicator, in terms of total credits, is altered by the credit in foreign currency but for this one there is always the possibility of an external financing.

The financing resources are representing a major concern of the banks when considering the balance sheet increase and aiming to secure an efficiency as good as possible.

The commercial banks liabilities by the end of 2006 were covered by their own resources at the level of 12.2% and by drawn resources at the level of 87.8% while, from the point of view of the origin, 77.5% represented internal resources, and 22.5% external funds.

**The evolution of the credit institutions passives***Table 4*

	2005	2006	2006/2005 %
Total liabilities, of which:	130,272.6	175,460.1	34.7
External liabilities, of which:	27,162.7	39,456.2	45.3
- loans from foreign banks	11,793.4	20,484.6	73.7
- deposits of the foreign banks	7,530.9	8,522.2	13.2
Internal liabilities, of which:	103,109.9	136,003.9	31.9
- deposits of the non-bank clients	74,946.4	96,581.0	28.9
* Retail deposits	34,466.0	44,319.5	28.6
* Corporate deposits	40,480.4	52,261.5	29.1
- Government deposits	4,685.5	5,423.5	15.8
- Capital accounts	15,861.9	20,777.9	31.0
- Inter-banks liabilities	3,200.9	6,248.4	95.2
- Other liabilities	4,415.2	6,973.0	57.9

Source: RNB.

The deposits from clients, which represent the resource the most disputed by the banks, recorded relatively moderated dynamics, 28.9%, both segments, retail and corporate, showing a similar evolution. Because of this reason, this position of passive is reducing its contribution to the aggregate balance sheet of the commercial banks from 57.5% in 2005 to 55.0% in 2006.

During the first half of the year, the deposits from clients recorded a progressive slow down of the rhythms of increase, simultaneous with the acceleration of the crediting process. The situation has been worsened by the modification of the RMO requirements which narrowed even more the handling margin of the banks as far as this resource is concerned. Thus, it became necessary to improve the conditions being offered for the saving products.

As for the financing internal resources in Romania there have been two important tendencies which the banks have had to face:

- *A sensible reduction of the saving capacity and propensity of the clients, within an economy considerably far away from other countries located in the region, by the very low level of its ratio deposits/GDP;*

- *The deposits at sight acted as the engine of the increase of the total deposits. Comparatively to the previous year, this type of resource recorded the most dynamic development, on both segments of clients.*

The slowing down saving process has been only partially offset by the increase of the placements with investment funds, despite the fact that during the first half of the year their activity has been less performing. According to the statistics published by the National Union of the Collective Placement Organisms, in 2006 the net entries of capital to the investment funds counted for 274 million lei (equivalent to about 81 million Euro), out of which 232 million lei went to the diversified and equities funds, namely about 3 time more as comparatively to 2005.

The value of the net assets of the open investment funds amounted over 633 million lei, with an average yearly increase of 86.7%. To note that the largest contribution goes to the corporate investors, which hold 56.5% of the assets value.

*The bonds issuance* in lei on the domestic and international market of capital, meant to secure the resources in national currency over longer periods of time, is a characteristic feature of the last year.

- The majority of the issues have been placed on the Romanian market (Pro Credit Bank - 40.3 million Lei, with a fixed interest of 8.5%; Banca Comercială Carpatica – 36.8 million Lei, with an interest of 10.43% per annum and BCR – 243 mil. Lei with a fixed coupon of 7.25% and maturities by 3 years).

- The only one issue on the international market of capital belonged to BRD (735 mil. Lei with an interest of 7.75% per annum and maturities by 5 years).

Thus, we have to notice the increasing interest of the foreign investors for the bonds issued in lei, under the circumstances of the steady appreciation of the national currency and the convergence of yields in lei.

These have been issued either on the domestic market (World Bank, Dexia, Kommunalkredit Bank AG), or on the European market and even on the Japanese market (the Development Bank of Germany KfW, the agency for export credits of Norway – Eksportfinan Rabobank Holland, KommeKredit Bank of Denmark). A number of these issuers are involved also in the financing of some Romanian entities, generally speaking, local communities.

The bonds in lei keep on remaining an option for the financial markets in 2007 as well, the sign being provided by Erste Bank in June. Similar intentions have been also announced by a number of local banks such as Reiffeisen Bank, Citigroup and Bancpost, as well as by EBRD.

*The capitalization process of the banks* kept on developing in 2006 as well, aiming both the increase of business capacity and standing with the requirements enforced by the RNB regulations as regards the crediting in foreign currency. The increase of the self capacities has been based on the increase of the social capital and of the funds out of the profit repartition, on one side, and, on the other side, on the increase of the subordinated debt. Increases of capital have been operated, for instance, by Eximbank (+182 million EUR), Bancpost (+80 million EUR), Banca Românească (+67 million EUR), Piraeus Bank (+25 million EUR), Pro Credit Bank (+1million EUR). By the end of the year, for the first time after 1989, the Ministry of Finances proceeded to a considerable infusion of capitals to CEC, after stopping the privatization of this bank, counting for 500 million Lei.

The own capitals of the commercial banks are supported by the paid in social capital to which there are various funds, generated by every and each bank out of the achieved profit, to be added. The main funds fed out of the profit are the reserve fund and the risk fund to which there are other funds to be added as well.

By the end of 2006, the paid in social capital counted for 45.7% of the own capitals, the difference being found in the funds thus established. Some of the banks have the additional capital included in the social capital, the additional capital meaning basically the subordinated debt and reserves out of the patrimony re-evaluation.

By the end of the previous year, the additional capital counted for 25.6% of the own capitals while the non-distributed profit, as another component of the own capitals, counted for 10.8%.

*The interests in force on the market* are found as implying effects on three separate plans: the deponents, those applying for borrowing and the credit institutions working with both the deponents and the borrowed entities. The interests are representing costs for some of them, income for others so that they are affecting directly the profitability of all the players involved in business.

Historically speaking, the interest may cross different stages, with an up warding or down warding trend.

During the last year, 2006, the interest decreased during certain periods while during other periods they have increase with stagnation periods in-between. The increasing competition as well as the desire of increasing the business volume obliged the banks to reduce the interest to the credits in lei and, as a consequence of a slowing down saving process, the interests for the resources drawn from clients increased.

**The main interest rates (% p.a.)***Table 5*

	The yearly average		December average	
	2005	2006	2005	2006
BUBOR 3M	9.79	8.76	6.99	8.75
Interests – assets in lei	11.98	10.20	10.01	10.28
Interests – liabilities in lei	6.29	5.16	4.42	5.43
Gap assets/liabilities in lei	5.69	5.04	5.59	4.85
Interests – credits in lei	19.19	13.90	15.72	13.44
Interests – deposits in lei	6.22	4.97	4.23	5.08
Gap credits/deposits in lei	12.97	9.11	11.49	8.36

Source: RNB.

*The interests for operations in lei* have recorded a different behavior in 2006 as comparatively to the previous years, the following aspects to note in this respect:

- The tendency of the average interest rates on credits to get closer of each other for both segments of clients, corporate and retail. The strong competition for the retail credit which has been carried out by the banks resulted in the decrease of the interests in force by almost 4 p.p. as average (18% in December 2005 – 14.3% in December 2006).

As for the corporate credit the reduction was smaller (from 13.9% to 12.6%), the interest difference between the two segments got diminished from 4.1 to 1.7 p.p.

- The opposite evolution of the margin against BUBOR, of the interests on credits and deposits. The interest margin for credits diminished almost by half as comparatively to the previous year (from 8.79% to 4.69%), while for deposits it increased by about 1 p.p. (from 2.76% to 3.67%)

- The 3 months inter-banking market (BUBOR) interest increased as a consequence of the RNB decision, from 7.65% to 9.16% in November; in December, the inter-banking interest decreased to 8.75%.

- The equalization of the remunerated interest for deposit at term for the two segments of clients, corporate and retail. During the previous years, the interests applying to the retail deposits have been higher as comparatively to those applying to corporate deposits; in 2006, the situation changed completely so that by the end of the year the respective interests leveled 6.9%, respectively 6.8%.

*The interests for the foreign currency operations* recorded smaller changes for Euro, the average interest rates for credits showed a slight

decrease (9.1% in December, comparatively to 9.8% in December 2005) for retail and a moderate increase for corporate (7.2% in December 2006 comparatively to 6.9% in December 2005). As for the deposits at term, there was a slight increase for retail, from 2.9% in 2005 to 3.1% in 2006 while for corporate the increase went from 2.9% to 3.3%. The interests showed slight increases for USD for all the categories: credits, deposits, retail and corporate.

The policy run by the banks joint to the one promoted by the RNB resulted in the decrease of the gap of interest by total assets/liabilities, of 0.65 p.p. as annual average, respectively 0.74 p.p. by the end of the year.

*The banking system supervision* has been exercised very carefully by the National Bank of Romania in accordance with the prerogatives stipulated by its own statute.

The decisions taken by the Central Bank in 2006 aimed:

- The successive increase of the quotas for setting up RMO from 35% to 40% as for the liabilities in foreign currency and from 16% to 20% as to the liabilities in lei;
- The increase of the monetary policy interest by 1.25 p.p. (from 7.5% to 8.25% in February and 8.75% in June);
- The intensification of the process of sterilization of the market liquidities, including the standardization of the time table for organizing the auctions for deposits;
- Maintaining and even hardening by administrative means the control of the increase of consumer credit, as factor of inflationist pressure.

As a consequence of the way the commercial banks carried out their activities and of the RNB supervision, there were not worrying events to be identified in 2006; on the contrary, the system kept on remaining remarkably stable and providing a good labor conscription.

*The banking distribution network* plays an ever bigger part in the credit institutions vision as the units network keeps on remaining the main distribution channel.

Although the banks are paying big efforts in order to develop alternative channels, these are not yet in the position, to a larger extent, to compete the basic channel which the banking unit. The unit network is considered as being a competitive advantage for increasing the sales volume and extending the clients basis.

The territorial units of the commercial banks counted by the end of 2006 for 4,401 by 25.2% more that in 2005. CEC is the bank with the most extended banking network, 1,406 units in 2005 and 1,391 units in 2006. In 2006, CEC held a weight of 31.6% in the frame of the national network.

As far as the market player position is concerned, depending on the network size, there have been two notable movements taking place in 2006, respectively BRD getting the leading position and Banca Transilvania getting the third position. Although opening a significant number of new units, Banca Comercială Carpatica kept its 5th position.

The policy of expanding being adopted by the main market operators led to an increase of the weight held by the first 5 banks of the system, from 43.0% by the end of the year, as comparatively to 35.4% in 2005.

#### The number of banking units of the main banking operators

Table 6

	2005	2006	2006/2005
BRD	326	600	+ 274
BCR	372	473	+ 101
Banca Transilvania	215	341	+ 126
Reiffeisen Bank	215	265	+ 51
Banca Comercială Carpatica	116	215	+ 99

Source: banks site.

The efficiency of the banking system is directly linked to the substantial increase of the business volumes, based mainly on the attractiveness of the products offer in terms of costs and less on the extension of the client basis. Typical for 2006 is the fact that this was the year of additional increases generated by the expansion of the unit network, including the increase of the number of employees as well.

According to the RNB, the net profit achieved in 2006 at the level of the banking system amounted to 2,279 million lei (equivalent to about 647 million EUR), with an increase of 15.4% as comparatively to 2005.

#### Efficiency and risk indicators

Table 7

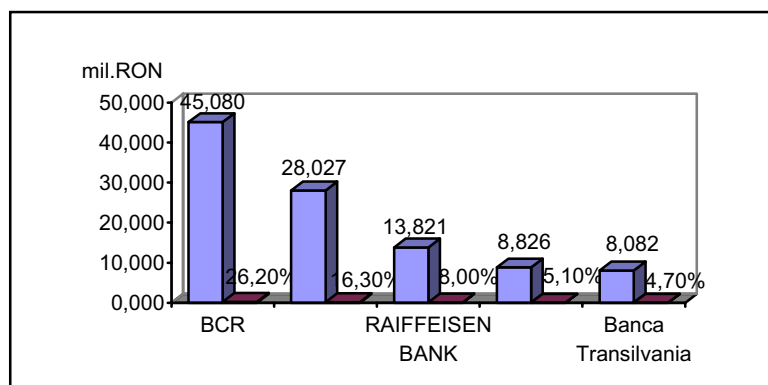
	2005	2006	2006/2005
Net profit	2,060	2,279	+ 10.6%
ROAE	14.9	12.1	- 2.8 pp
ROAA	1.9	1.5	- 0.4 pp
Solvability (12%)	21.1	17.3	- 3.8 pp

Source: RNB, author's calculations.

Mainly as a result of a more stressed orientation towards the placements in credits, the index of the capital adequacy has been affected by the increase of the risk profile of the system, resulting in the decrease of this indicator by 3.8 p.p., after three years of keeping a value around 21%.

After long time of good experience and competition, the Romanian banking system is authoritatively dominated by 2 banks which have strongly consolidated their position on the market: Banca Comercială Română and Banca Română de Dezvoltare Société Générale.

The 5 top banks by the end of 2006 are including operators of considerable tradition on the podium but new comers, i.e. banks replacing other banks in the classification.



Source: RNB.

**Figure 1.** TOP 5 banks, according to the assets size in 2006

The last period of time shows that the small banks are paying big efforts in order to achieve more aggressive increases with the purpose to gain a better position of market quotas.

Such banks which previously were quoted with less than 2% achieved quite remarkable results in 2006. Banks such as OTP Bank, Volks Bank Romania, Egnatia Bank and other should not be ignored when considering this category. However, this effervescent activity at the level of small banks platoon does not disturb the large banks platoon, which is holding the leadership.

What is really surprising is the behavior of the segment comprising the 6 subsidiaries of foreign banks which recorded a modest increase of



4.8% only, with corresponding consequences as regards their market quotas, declining from 7.5% to 5.8%.

Concerning the evolution of the top 5 banks, there are several major changes which should be considered:

- Banca Transilvania enters the top on the 5<sup>th</sup> place, advancing thus by 3 positions as comparatively to 2005;
- Following the merge with Banca Tiriatic, HVB goes up from the 5<sup>th</sup> to the 4<sup>th</sup> position;
- ING gets out of the top as a result of its poorer activity and goes to the 7<sup>th</sup> position, with an assets value close to that recorded by Alpha Bank and CEC;
- The 2 banks of the system (BCR and BRD) are strengthening their positions with a slight impact on the system concentration.

*The position of the first 10 banks according to the assets they are concentrating is conclusive. By the end of the last year they held 79.1% of the assets recorded by the entire system.*

#### TOP 10 banking operators on the Romanian market

Table 8

	Assets – bil. lei		Market quota %	
	2005	2006	2005	2006
1. BCR	8.96	13.33	25.6	26.2
2. BRD	5.22	8.28	15.0	16.3
3. Raiffeisen	3.0	4.09	8.6	8.0
4. HVB – Tiriatic	2.5	2.60	7.4	5.1
5. Transilvania	1.34	2.39	3.9	4.7
6. Bancpost	1.55	2.28	4.9	4.5
7. ING Bank	1.84	2.14	5.3	4.2
8. Alpha Bank	1.32	2.11	3.8	4.2
9. ABN Amro	1.32	1.56	3.8	3.1
10. Volksbank	0.51	1.38	1.4	2.7

Source: RNB.

If limiting the classification to the first 3 banks, we shall find out that BCR, BRD and Raiffeisen are already holding half of the total market, with assets amounting 25.5 billion euro.

*The concentration degree within the system, expressed by the HHI<sup>(1)</sup> indicator, keeps on increasing in 2006, up to 1,171 against 1,122*

in 2005, so that it keeps on maintaining within the low zone of a moderate concentration (close to the competitive one).

This is due to the improvement of the positions held by the system performers, BCR and BRD, which have consolidated their market quota up to 26.2%, respectively 16.3%. The assets increase being stated out in case of many smaller banks, although significant had no influence on HHI.

Despite the fact that during the last years the commercial banks from Romania developed very much their unit network, by comparison with other countries, this is considered as being still insufficiently extended in order to secure services of high quality to the clients the banks are working with.

*The comparison between Romania and some of the European countries*, mainly with the last but one wave of countries entering the European Union, allows the evaluation of the level reached by our country from the point of view of the number of credit institutions which are operating on the market and the financial intermediation degree.

#### **The credit institutions number from some EEC and West-Europe countries**

*Table 9*

	<b>January 1<sup>st</sup> 2004</b>	<b>January 1<sup>st</sup> 2007</b>		<b>January 1<sup>st</sup> 2004</b>	<b>January 1<sup>st</sup> 2007</b>
Slovenia	27	30	Poland	659	30
Czech Republic	79	66	Slovakia	28	34
Estonia	25	26	Romania	-	39
Cyprus	409	337	Germany	2,268	2,106
Lithonia	74	241	France	1,577	1,440
Hungary	238	241	Great Britain	457	440
Malta	17	23	Finland	396	381

**Source:** BCE.

The number of banks differs very much from one country to another with an extreme situation, namely a large number of banks as against the country size, in Cyprus (337 credit institutions), Hungary (241 credit institutions) and even Lithonia as well (80 credit institutions).

This indicator is only partially relevant as, in completion, the network density, i.e. the number of inhabitants per one banking unit,

offers a better picture on the banking cover from the point of view of the capability to offer banking services to the clients.

### The inhabitants number per 1 banking unit

Table 10

	2001	2004	2005
Slovakia	2,778	2,829	2,887
Czech Republic	5,839	5,719	5,601
Cyprus	696	757	797
Hungary	3,454	3,384	3,231
Poland	9375	7,631	7,511
Slovakia	5,736	4,836	4,717
Romania	8,060	7,129	6,150
Germany	1,527	1,820	1,872
France	2,346	2,360	2,316
Great Britain	4,057	4,304	4,397

Source: BCE.

The indicator number of inhabitants/1 banking unit makes Romania get closer to other countries, by its 6,150 in 2005. The developed countries are showing also certain differences, from 1,872 inhabitants/unit in Germany to 4,397 inhabitants/unit in Great Britain which is over-passed by Slovenia with 2,887 inhabitants/unit and Hungary with 3,231 inhabitants/unit (Cyprus may be considered as an atypical case, without relevance for the respective analysis).

The financial intermediation degree is another important indicator which allows an image on the level of development of the banking activity by means of weighing certain indicator of the GDP.

Romania holds a lower degree of the financial intermediation, mainly when comparing with countries of Central and East-Europe. Out of the countries entering the European Union by the last but one wave, a better position is held by Czech Republic, Hungary and Slovenia, but none of these countries is closing up to the results recorded by the countries members of the Monetary Union or the EU-25.

**Financial intermediation***Table 11*

<b>% in GDP in 2005</b>	<b>Assets</b>	<b>Credits</b>	<b>Retail credits</b>	<b>Corporate credits</b>
Romania	44.1	20.8	7.3	1.8
Czech Republic	10.6	41.6	14.6	9.9
Slovakia	95.4	38.7	12.5	8.2
Poland	62.5	31.9	15.1	5.4
Hungary	84.9	51.8	17.1	10.3
Slovenia	109.8	51.7	15.7	5.0
Monetary Union	265.5	123.5	52.4	35.5
EU-25	280.0	125.9	60.6	43.2

**Source:** BCE.

As for Romania, there are two phenomena with contradictory effects on the financial intermediation degree. On the one side, the effort paid by the RNB for the inflation targeting, which implies a temporization of the credit and, on the other side, the needs for financing which require for the credit extension, with direct effects on the financial intermediation. In terms of tendency, there is no doubt about the fact that Romania would secure, in time, a satisfactory weight in the GDP, close to other countries level, for both the assets and the credits.

**Note**

<sup>(1)</sup> Herfindahl hirschman indicator, used for the evaluation of the concentration degree is calculated as sum of the market quotas squares (hhi < 1000 = totally competitive market; 1000 < hhi < 1800 = moderately concentrated market; 1800 < hhi < 10,000 = strongly concentrated market)

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# **THEORETICAL DELIMITATIONS: THE EUROPEANIZATION OF PUBLIC ADMINISTRATION AND ITS INSTITUTIONAL LEVERS**

■

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**Abstract.** *The specter of possible significances of the Europeanization process is impressive: it can be analyzed as a transnational process (diffusion of Western norms, styles and behaviors within the Western Europe); an institutional process of adaptation to the EU's demands; a counterbalance to globalization or finally, as a specific strategy for managing the worldwide conflicts. From all these, the "Europeanization as institutional adaptation" approach has caught the attention of the doctrine of administrative studies.*

*This article attempts to name the differences between the Europeanization by deepening and the Europeanization by enlargement and thus it suggests that the context of the interactions the European Community has with its candidate countries needs a special attention. We will thus focus on identifying (on conceptual level) the institutional levers the Union uses in influencing the administrative order of non-Member States that made the first steps in becoming a part of the European project. Romania – prior 2007 will constitute the subject of analysis for the instruments identified in the first part of the paper.*

**Key words:** Europeanization; public administration; administrative conditionality at European level; European's Union enlargement; European Administrative Space.

**REL Classification:** 13G, 16I, 20C

■

### Preamble

Leaving aside the pure intentional objectives of political and ideological nature, the European Union (EU) can be seen as the most visible international actor in the institutional Europe of today. It is for this reason yet not in the same vein as the debates on the socialization of sovereign entities<sup>(1)</sup> in the context of enlargement relations<sup>(2)</sup>, that in this article we will assume the direct influence EU places upon norms, practices and national values otherwise particular to national European states.

Actually, twenty seven of the above (since January 2007) have agreed on participating and contributing to common regional, social, agricultural and monetary markets, creating in between a single European space of security and defense. Conceding an amount of their sovereignty to a supra-national entity such as the EU, the member states have also agreed on accepting the European acts (as defined by Article I-32 of the European Constitution) as a special category of external demands to which answering is usually imperative and driven by common formulated models, standards or institutional arrangements (Andersen, 2004, pp. 17-18).

Possible packages of alternative solutions, the latter seem to replace the decrepit internal institutional arrangements, with minimum effort and political debate (Andersen, 2004, p. 21). In this light, the Europeanization process, generically understood as the EU's impact on the Member States' national orders, is perceived as endogenous to the EU's borders and consensus-generator. Still, Europeanization may be (and is, undoubtedly) exported (Papadimitriou, 2002, p. 4, Bulmer, Radaelli, 2004, p. 2). Its products are concentrated in merely 80.000 of *acquis communautaire*, position papers, country reports, guidelines for application, eligibility criteria and twinning manuals.

The specter of possible significances of Europeanization is impressive: it can be analyzed as a *transnational process* (diffusion of Western norms, styles and behaviors within the Western Europe); an *institutional process of adaptation* to the EU's demands; a *counterbalance* to globalization or, finally, as a *specific strategy for managing the worldwide conflicts* (Featherstone, 2003). From all these, the "Europeanization as institutional adaptation" approach has caught the attention of the doctrine of administrative studies.

This article attempts to name the differences between the *Europeanization by deepening* and the *Europeanization by enlargement*<sup>(3)</sup> and thus it suggests that the context of the interactions the European

Community has with its candidate countries<sup>(4)</sup> needs a special attention. We will thus focus on identifying (on conceptual level) the institutional levers the Union uses in influencing the administrative order of non-Member States that made the first steps in becoming a part of the European project.

### 1. The Europeanization by deepening in context

The area of analysis for the interactions the EU has with states covers mostly the EU's geographical borders. In this article, the *Europeanization by deepening* is to be seen then as the bilateral interaction of the Community with its Member States which points towards the integration of the European economic and political dynamics to the national organizational logic of public policy making (Ladrech, 1994, p. 69).

To the question of "How does the EU interact with its Members?", Knill and Lehmkuhl answered in 1999, indirectly and not totally original<sup>(5)</sup>:

*EU interacts with its Members by means of:*

a) *Indicating European models* and forcing their implementation in Member States (*positive integration*). In such case, Europeanization basis itself on the *a priori* existence of national institutional adjustments (e.g., the European environmental policies);

b) *Altering the national state of art and inducing the change at this particular level (negative integration)*. At this point, Europeanization becomes similar to altering domestic structures according to the distribution of power and resources between the actors involved in the game (e.g. rules of single market); and

c) *Promoting new values*, which generate expectations from the states and modify their preferences (*framework integration*). Here, Europeanization becomes the process of institutional adaptation resulted from the changes of domestic strategies according to the newest national orientations.

To these instruments, Töller (2004) adds a forth:

d) *The European lack of action* (translated by the absence of a certain regulation), which normally is pointed toward eluding the legal traditional procedures and choosing the informal cooperation as a regulation framework.

EU exerts then upon Member States *pressures of adaptation*, occasionally offering them suggestions for re-balancing the inter- and intra-state powers or simply principles of a possible (sometimes vaguely demonstrated) good European practice. In connection with the stimuli they receive, the Member States react.

In this sense, Börzel and Risse (2000, p. 11) speak of:

a) *Absorption* – when Member States incorporate European policies or ideas and readjust their institutions, respectively, without substantially modifying existing processes, policies, and institutions (minor change);

b) *Accommodation* – when the adjustment to the European stimuli does not change the essence of domestic order (moderate change);

c) *Transformation* – when old institutional and behavioral models are replaced by newer ones (major change).

To which Radaelli (2003, p. 37 *et seq.*) adds:

a) *Inertia* – as the absence of change; and

b) *Suppression* – present when after implementing the EU's demands, the national policy becomes "less European" than before.

The attempt in enframing national reactions to this typology is rather difficult: not because identifying inertia or transformation wouldn't be possible, but because demonstrating a direct causal relation between the state change and the EU's pressure is hard to achieve (Featherstone, 2003). Secondly, classifying the eventual domestic reactions should be accompanied by a certain amount of prudence and self-limitation: after all, the effects we study represent only the perspective of national alterations and thus assume the unilateral relation between the Union and the Member State.

## **2. Europeanization by enlargement – the specificity of an asymmetrical relation of power**

Defined as EU's impact on domestic order of candidate states, the *Europeanization by enlargement* makes reference to an asymmetrical relation established between the agent of conditioning (European Community) and its subject (the candidate). The approach to be employed here is again, the top – bottom one<sup>(6)</sup>. This is mainly because the reports of the integration process are clearly established by the exclusive strategy the EU is known for (F. Schimmelfennig in Linden 2002, pp. 12-15): for the candidates, *nothing is agreed until everything is agreed*.

Competing in the "race for integration", the candidate countries aim at approaching a *minimum necessary threshold* of the Community. In



doing so, they will respect the rules of training usually unilaterally established by the EU. The EU integration is then to be understood as contracting exogenous models of institutional and/or value related change, while Europeanization, as the process of adjusting the quoted models to the domestic orders of candidate countries (Radaelli, 2000, p. 4, Wincott, 2003, p. 282, Andersen, 2004, p. 3).

Of course, such a discourse raises at least two questions: is the existence of a certain degree of non-conformity to the *minimum threshold* sufficient for justifying an authoritarian Union in relation to the candidate states?, and, Are there implied ideal models for action as instruments for measuring the national performances?

To the first question, the answer seems (due to current practices in the area) rather affirmative (Grabbe, 2003, p. 318), although the image of the EU as a learning organization is not a mystification, and the foregoing enlargements do not confirm it (Granell, 1995, p. 118 *et seq.*). The “whys” for this choice are given by the fact that in this last enlargement process (ended in January 2007) and in a context of asymmetrical power with the Union, the candidate countries were forced to transpose the *acquis* prior to their integration (a situation that differs from the case of Austria, Finland and Sweden after the EFTA *European Free Trade Association* Association agreements<sup>(7)</sup>). They were also under the safeguarding clause, curiously enough considered by the European Parliament as (only) a “delay in the alignment to the EU’s internal market” (2005/2028(INI), point 22). In addition, continuing the pressures after signing the Accession Treaty (COM 2005-534, point 3.2.) by enumerating the possible instruments for sanctioning inadequate behaviors (e.g.: letters from drawing attention of the political authorities, high level meetings, monitoring reports, etc.) validates the legitimacy of an hypothesis according to which Brussels still benefits of power of coercion and influence (the mechanism of „carrots and sticks”<sup>(8)</sup>) in its relation with the candidate countries (a state of art impossible to counterbalance by a eventual and real possibility of reaction<sup>(9)</sup>).

On the other hand, there are standards for measuring the performance of candidate states; however, there are not for all the areas and certainly, not under the title of an *ideal type*, but rather, of *unformulated standards* (as it proves to be the *European Administrative Space* – SIGMA, 1999).

On the background provided for by the *accelerated rhythm of adjustments* (Greece needed more than ten years to adjust to the single market – the time frame given to Romania and Bulgaria); the *openness to*

*the European influence*, possible to explain due to communist experience<sup>(10)</sup> and the *demands multiplying* on the integration agenda (Grabbe, 2003, pp. 306-307, Verheijen, 1998, p. 24), the last enlargement EU had experienced and for which the Copenhagen criteria were reinterpreted<sup>(11)</sup>, appears to be characterized by asymmetry, complexity and rapidity<sup>(12)</sup> of the alignment to the European demands.

### **3. The levers of the Europeanization of public administration – the specific of Europeanization by enlargement**

For the public administration and in accordance to the idea of *deepening*, the Europeanization is to be seen as a two level process: *the European level*, referring to the evolution of a distinct governing system, a new set of structures and public processes which interact with those already established by the Member States, forming the *second level*.

For Demmke (2004), the levers for impact implied by both dimensions are: the European legislation, the negotiation processes, the decision and implementation of, for instance, civil service, administrative cooperation, the European Court of Justice's jurisprudence and the administrative networks newly created in the European space.

Actually, the European Constitution (EC) deepens the fore-cited argument, making a distinction between the:

- Europeanization of basic principles (e.g.: "democracy", "citizenship", "efficiency", "efficacy", "rule of law") and development of general administrative principles (e.g.: "good governance", "openness", "fight against maladministration", etc.);
- Europeanization of national civil services, due to the limited interpretation of the free movement of workers and the restrictions in occupying a position of civil servant (cf. Article 39.4 EC);
- Europeanization by implementing and applying the secondary legislation (of the regulations regarding the equality in rights, provided for by Articles 137 and 141 EC);
- Europeanization due to strict interpretation of Article 10 EC and the jurisprudence of the European Court of Justice;
- Europeanization due to the impact of competition rules provided for by Article 86 EC and the privatization of former public services and enterprises.

This enumeration refers strictly to the Europeanization by deepening. In regard to the European enlargement, the following paragraphs may be seen as relevant.

In 1993, the Copenhagen European Council established the access conditions that the Central and Eastern Europe candidates required in order to become Members of the Union (point 7.A.iii):

1. Stability of institutions guaranteeing democracy, the rule of law, human rights and respect for and protection of minorities;
2. Existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union; and
3. Ability to take on the obligations of membership including adherence to the aims of political, economic and monetary union.

In the same year, entered into force the European Interim Agreement, act signed by the European Community and the candidate countries, stipulating in its Article 98 that: „Parties will promote the cooperation between their administrative authorities, including by exchange programs, in order to improve the level of common knowledge of their systems' structure and functioning". The new approach was actually to be confirmed an year later, by the White Paper: *Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union*, which, without being part of the accession process, enumerates under the "Specialised Technical Assistance" chapter, point 5.6, some levers that made Europeanization possible:

- a) assistance with appraising the costs and benefits of different sequences of approximation;
- b) direct and rapid access to complete and up-to-date EU legislative texts and jurisprudence, as well as translation services;
- c) advice from legal and technical experts, on the Union's legal system and, sector by sector, about the interpretation of Community texts and the drafting of national laws;
- d) information concerning implementation and enforcement mechanisms in the Member States;
- e) institutional exchange programmes and TAIEX Programme;<sup>(13)</sup>
- f) access to PHARE, Erasmus, Socrates and Leonardo da Vinci financial assistance.

Two years later, in 1997, the Luxembourg European Council launched the enlargement procedure – a “comprehensive, inclusive and ongoing process, which will take place in stages” and organizes the

enhanced pre-accession strategy, through which the Europe Agreements remain “the basis of the Union's relations” with the applicant states, while the Partnerships become “key elements of the enhanced pre-accession strategy which will mobilize all forms of assistance to the applicant countries of Central and Eastern Europe within a single framework” (points 14 and 16 of the Conclusions of the Luxembourg Council). Now, in the purpose of supporting the *acquis*' adaptation process, the financial assistance and screening are enforced (“the enhanced strategy for pre-accession will be accompanied by the analytical study of the EU's *acquis* for each candidate country”) – table 1.

To summarize, the levers of Europeanization by enlargement, as they appear in the Strategic European documents of the European Council, are (non-exhaustive)<sup>(14)</sup>:

1. *Acquis communautaire*, naming the common rights and obligations applied to all EU Member States, comprising the legal norms that regulate the activity of European institutions, actions and policies, namely:

- the content, principles and political objectives of the constituent Treaties of the European Community (ECCS, EEC, ECEA) and the ones that followed (The European Single Act, Maastricht Treaty and Amsterdam Treaty);
- the legislation adopted by the European institutions for putting into practice the Treaties' regulations;
- the jurisprudence of the European Court of Justice (so, also, the principles of the *European Administrative Space* – Peretó, 2005, p. 2);
- declarations and resolutions that were adopted inside the European Union;
- common actions and positions, signed conventions, resolutions, declarations and other acts adopted within the External and Common Security Policy (ECSP) and the cooperation in the field of Justice and Home Affairs;
- international agreements to which the European Community is a member, as well as those signed by the EU's Member States in connection to the latter<sup>(15)</sup>.

**Stages of conditioning the relation between the European Union and the candidate countries from the Central and Eastern Europe**

Table 1

<b>First Step</b>	Europe Agreements			
<b>Second Step</b>	Copenhagen criteria			
<b>Third Step</b>	Essen Pre-accession Strategy	Europe Agreements		
		PHARE Programmed		
		White Paper		
		Structured Dialogue		
<b>Fourth Step</b>	Agenda 2000-Reinforced Pre-accession Strategy	European Conference		
		Accession Negotiation Process		
		Accession Process	Accession Negotiations - 31 Acquis Chapters	
			Screening of the Acquis	
			Review Procedure	
			Reinforced Pre-accession strategy	Europe Agreements
				Accession Partnerships
				Pre-accession Aid and PHARE

Source: L. Demetropoulou (2002) in Spendzharova (2003, p. 147)

## 2. Pre-accession funds: PHARE, ISPA and SAPARD

▪ PHARE – relies primarily on the institutional consolidation and assistance support in the investment area<sup>(16)</sup>. It provides structural assistance at regional level (institutional construction for economic and social cohesion) and finances measures taken in the fields of cross border cooperation and nuclear security;

▪ ISPA – organized under the rule of Council Regulation (CE) no.1267/1999 of 21 June 1999; it finances: rehabilitation of the environmental infrastructure (modernizing the water supply resource, sewerage, treatment of used waters, management of urban refuse) and enhances and modernizes the transport infrastructure (modernizing of national roads, rehabilitation and modernization of railways, etc.); and,

▪ SAPARD, organized under the Council Regulation (CE) no.1268/99 of 21 June 1999); it finances the structural reform of agricultural and rural development sectors, as well as the implementation of the Common Agricultural Policy and its subsequent legislation.

3. *Institutional twinning* – One of the main challenge the candidate countries of the last enlargement had to deal with was the administrative capacity criterion established in Madrid. In this sense, EU launched in 1998 a human resources and financial mobilization of twinning of administrations and agencies. Concentrated at the beginning on the top one priority sectors (agriculture, environment, public finance, justice and home affairs and preparatory measures for introducing the structural funds), the twinning projects are now covering all the areas of the acquis<sup>(17)</sup>.

If we assume that national actors are strategic multipliers of utilities, interested only in maximizing their power and welfare, and that they exchange information, threats and promises during the integration negotiation process, while the final outcome depends upon the relative strength of negotiation each possesses, then, it can be concluded that *the formal models of the Union are absorbed at domestic level, only if the expected rewards exceed the internal costs of the model's absorption*.

Thus, the cost-benefit balance will depend on:

- a) The importance of the norm to be absorbed – is it seen by the EU as a pre-condition for rewarding? (e.g. granting the membership?);
- b) The clarity of the norm to be absorbed;
- c) Reward (dimension, time upon receiving, period of “use”, etc.);
- d) EU's credibility;
- e) Internal costs of norms' absorption; and,
- f) The degree of opportunity of the norm's absorption.

According to Sedelmeier (2006, p. 147 *et seq.*) and relevant from the point of view of the Europeanization levers already identified, the mechanism the former candidate countries employed in absorbing the European norms was that of *external stimulation* by presenting the advantages of EU's membership; the social learning process or that modeled by previous learning seems not so important. In support of this statement, next to the country reports and the conclusions of annual monitoring, comes the list of benefits EU links to the membership status. The latter was present in almost any political discourse of the Eastern European countries: a stabile political and economic climate that will ensure a durable development; a higher predictability and stability of the economic environment; increase of the access on European capital and

investment markets, new equipment and high tech; presence of domestic economic agents on a single, large market; strengthening the national security in order to integrate to ECSP; the European citizenship; perspectives for professional training and access to the European labor market for national citizens<sup>(18)</sup>.

#### **4. Levers for the Europeanization of public administration in Romania (prior 2007)**

Created for regulating the association between Romania and the European Community, “acknowledging the necessity that the former continues and finalizes, with Community’s aid, the transition process to a new political and economic system capable of respecting the rule of law and the human and minority rights, able to exercise the political pluralism based on free and democratic elections and ensure the economic liberalization for developing a market economy”, the Europe’s Agreement<sup>(19)</sup> was the first instrument of formal national contact with the enlargement process.

[...] For Romania, the Union is firstly a door to a balanced and harmonious structure, which organizes the continental micro- and macro-cosmos under the European civilization flag, a common house where each member keeps its identity (in DOC/97/18).

The crystallization of the Europeanization’s mechanisms for Romania as a candidate country happened in 1999, at Helsinki, when:

Determined to lend a positive contribution to security and stability on the European continent and in the light of recent developments as well as the Commission's reports, the European Council has decided [...] to begin negotiations with Romania [...] on the conditions for [its] entry into the Union and the ensuing Treaty adjustments. (Conclusions, point I-10).

From this moment on, it became clear the impact of the Union on the Romanian domestic order; it can be also quantified thanks to the three classical, and already mentioned institutional levers of the Europeanization: the *acquis communautaire*, the pre-accession financial assistance and the institutional twinning.

##### *A. Acquis communautaire*

Between 2000 and 2004, Romania was involved in a constant process of negotiation of the *acquis* – see table 2.

**The evolution of the accession negotiations between Romania  
and the EU**

Table 2

Year	Opened chapters	Closed chapters
2000	9 chapters	12 – Statistics 16 – Small and Medium Size Enterprises 17 – Science and Research 18 – Education and Professional Training 26 – External Relations 27 – External and Common Security Policy
2001	8 chapters	5 – Law of Commercial Societies 8 – Fishery 23 – Consumer and Health Protection
2002	13 chapters	11 – Economic and Monetary Union 13 – Social Policy 15 – Industrial Policy 19 – Telecommunications and IT 20 – Culture and Audio-Visual 25 – Union
2003	----	2 – Free Movement of Persons 4 – Free Movement of Capital 9 – Transportation Policy 10 – Taxes 28 – Financial Control
2004	----	3 – Free Movement of Services 6 – Competition Policy 7 – Agriculture 14 – Energy 21 – Regional Policy and coordination of structural elements 22 – Environment 24 – Justice and Home Affairs 29 – Financial and Budgetary dispositions 31 – Others

*B. Pre-accession funds*

- PHARE<sup>(20)</sup>: Between 2000-2003, Romania received more than 1 billion Euros to fulfill the political and economic criteria, strengthen the



administrative capacity, respect the obligations deriving from the acquis and accomplish the economic and social cohesion (via national programs of cross border cooperation and specific measures). Between 2004-2006, following a strategic multi-annual approach, the EU's financial assistance was targeted to specific programs for key sectors (public administration, public finance, agriculture, environment, justice, border management, minorities, economic and social cohesion) and neighboring programs with Republic of Moldavia, Serbia and Montenegro and Ukraine.

- ISPA: In 2000-2006, Romania received from ISPA, approximately 240 de million Euros per year. During 2000-2003, for instance, Romania closed 40 financial memorandums with ISPA comprising an amount of 1446 million Euros EU funds, that is over 70% of the total amount provided within the fore-mentioned time frame.

- SAPARD: The National Plan for Agriculture and Rural Development represented the basis for implementing SAPARD in Romania and was approved in December 2000 and revised in August 2003. It includes an amount of over 2 billion Euros (public and private expenses), of which 1.113,4 million is the EU's share. The four regrouped eligible priorities taken into consideration for Romania's case were: a) development of production and delivery of agricultural and fishery products; b) development of rural infrastructure; c) development of rural economy (investments in firms with agricultural, economic diversification and forestry profiles); d) development of human resources (improvement of professional training, technical assistance, including studies to support and monitor the program, information and publicity campaigns).

### C. Institutional twinning

Twinning programs in Romania were financed by PHARE. According to the EU data (available online in the information brochure: *Twinning*, 2006); between 1998-2005, Romania was the candidate state with the largest number of twinning programs developed 191 (of 1110).

Thus EU also counted in Romania's case as a candidate country. Thanks to the 31 negotiation chapters, the institutional *models* that were suggested as good governing instruments, the *financial and technical assistance* it received for reforming matters, the periodical *monitoring* and the *consultancy and twinning* sessions, Romania was indeed a "consumer" of European goods<sup>(21)</sup>. Starting with January 2007, Romania becomes, theoretically speaking, a "producer" of Europeanization: the way this will cause further changes to the national administrative structures is the subject of another possible scientific investigation.

## 5. Conclusions

To recap the initial argument: EU counts also for candidate states. It counts, since Europeanization is a bi-directional, circular and cyclical process (Goetz, 2002, p. 4) only in the case of Member States, the candidates being ruled under the principle of “nothing is agreed until everything is agreed”. It counts, since pragmatically speaking, the statement of “Europe is open to all the countries from the continent sharing its values and agreeing on following its common policies” (Prodi, 2001, p. 34), should be completed with: “Europe is open to all states [...] *ending their accession negotiation*”. Again, it counts through the 31 negotiation chapters of the *acquis communautaire*, the institutional *models* that were suggested as good governing instruments, the *financial and technical assistance* it received for reforming matters and the periodical *monitoring* and the *consultancy and twinning* sessions that it organized (Grabbe, 2003, p. 312 *et seq.*). To summarize, EU matters since, most of the times, it puts conditions not only in accession (in Copenhagen, 1993 and Madrid, 1995), but also in adapting the *acquis*, safeguarding its contents or elaborating the methodology for eligible applicants within PHARE.

Generally, candidate countries are then “consumers” more than “producers” of Europeanization, the real possibility of influencing the negotiations being by modifying the tempo, and not the content (Papadimitriou, 2002, p. 7). This is actually a highly respected hypothesis possible to employ in future attempts of quantifying the actual influence EU brought to the public administration domain.

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### Notes:

<sup>(1)</sup> See Rosneau

<sup>(2)</sup> For pertinent comments on this matter, see Bardi et al. (2002, p. 227 *et seq.*).

<sup>(3)</sup> By this distinction, the authors related directly to the European ageing process (*deepening*) and its enlargement (*enlargement*). Such a clarification is needed since they both play in the dual game of European evolution. For further reading on this matter (on the argument of creating and developing the fore-mentioned typology), see Iancu, D.C. 2005. „Delimitări conceptuale ale procesului de europenizare”, Doctoral paper defended in September 2005 (National School of Political Studies and Public Administration, Bucharest).

<sup>(4)</sup> The specificity of the enlargement taken into consideration in this article relate to the Central and Eastern European countries (and, particularly, to Romania and Bulgaria). The argument of the Europeanization by enlargement can however be used for the case of the current candidate countries, as well.

<sup>(5)</sup> For comments on the theories involved here, see Scharpf (1997, p. 13) and Featherstone (2003, p. 14 *et seq.*).

<sup>(6)</sup> At this point, two possible approaches of the Europeanization may be formulated: a) *top – bottom* – EU unilaterally influences the Member/Candidate State; b) *bottom – up* – The Member/Candidate State unilaterally influences the EU.

<sup>(7)</sup> For a historic view on the EU's enlargements, in a comparative approach, see Ziller (2006).

<sup>(8)</sup> We talk here of the appraisal/sanctioning policy adapted to the successes/failures the states know inside or very close to the European space. For an analysis on conditioning as „the primary strategy through which international institutions promote the attitude of conformity among national governments”, see also Hughes et al. (2002, p. 3).

<sup>(9)</sup> Obviously enough, it could be raised here the possibility of withdrawing from the accession process. This is however not only irrational but also unreasonable. To this we add that candidate countries are just “consumers” of the European “goods”, with no real right to influence the decision making results à la Bruxelles (Grabbe, 2003, p. 313).

<sup>(10)</sup> There is a comment in need here: the situation post-1989 is not an equivalent to *tabula rasa* in relation to the EU's values. In return, the need for “returning to Europe” and thus accepting the Western values rather easily, may be seen as a mark of specificity for the former communist states now part of the EU. For a pertinent argument in this direction, see Papadimitriou (2002, pp. 5-6) and Agh (2002).

<sup>(11)</sup> Bugarič (2006, p. 204) quotes the cases when the Bulgarian, Lithuanian and Slovakian nuclear plants were closed or those of the reform of the institutional system of child protection in Romania. For other examples, see Grabbe (2002; 2003).

<sup>(12)</sup> Un example here is the Hungarian Parliament which adopted in five minutes half of the *acquis communautaire*, (A. Grzymala-Busse (2004) in Bugarič, 2006, p. 203).

<sup>(13)</sup> Unit of the European Commission DG for Enlargement, since 1996. It has the role of assuring to the candidate countries, new Member States and administrations in Western Balkans technical assistance on short period of time, for complying with the general objectives of the Commission and in the areas of approximation, adaptation and

implementation of the EU's legislation. Its services include consultancy, training sessions, working groups and conferences, monitoring processes, translations, working visits, access to databases necessary to interpreting the *acquis communautaire*, etc. Information regarding the assistance Romania has received via TAIEX are available online, in the TAIEX Activity Reports, at: <http://taiox.cec.eu.int>.

<sup>(14)</sup> The definitions that follow were found in *Dosarul relațiilor UE – România*, available on-line at: [www.eic.ro/Dosar%20UE%20RO.pdf](http://www.eic.ro/Dosar%20UE%20RO.pdf) and the official website of the Ministry of External Affairs: <http://ue.mae.ro/index.php?lang=ro&id=199>, accessed on 01.09.2006.

<sup>(15)</sup> A comparative perspective regarding the *acquis* in different stages of the EU's enlargement is to be found at Granell (1998).

<sup>(16)</sup> In developing the infrastructure needed in order to assure the conformity with the European legislation or the economic and social cohesion.

<sup>(17)</sup> The twinning programmes were and still are financed mostly from PHARE. Additional information on the allocated budgets, organizational rules and benefits of these programmes for the former Candidate countries are to be found in European Commission. 2005. *Institution Building in the Framework of European Union Policies. A Reference Manual on "twinning" projects* ([www.europa.eu](http://www.europa.eu)).

<sup>(18)</sup> Source: the official website of the Ministry of External Affairs: <http://domino.kappa.ro/mae/dosare.nsf/Integrare?OpenView> (accessed in June 2000).

<sup>(19)</sup> Ratified by Law no. 20 of 6<sup>th</sup> of April 1993 and published in the Official Gazette of Romania, part I, no. 73/12 April 1993.

<sup>(20)</sup> Source: Official website of the Ministry of External Affairs: <http://ue.mae.ro/index.php?lang=ro&id=199>, accessed on 01.09.2006.

<sup>(21)</sup> An argument in this respect can be found in Iancu, D.C. (in preparation). The author's point of views presented in this paper enhances a significant part of the thesis.

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## THE ECONOMIC SITUATION OF ROMANIA BY THE TIME OF THE ADHESION TO THE EUROPEAN UNION



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**Abstract.** *This material is an attempt aiming to get a picture on the economic situation of Romania by 31.12.2006, namely by the very moment of passing the border when our country has been admitted into the European Union.*

*As for a start, without politicizing in any way the content, I have proceeded to a slight incursion through the political events which have alternated within 2006 up to April 3<sup>rd</sup>, 2007 even, in order to eventually substantiate the way followed up by the economic and social evolution of Romania during this period. As a paradox, despite certain serious internal dissensions, which generated the reorganization of the government and the forming of a new Executive in a minority. The economic evolution, as well as the social one, of Romania proves to be a positive one, so that there is a number of growths, some of them even significant. The prime explanation is given by the Parliament agreement, based on which all the political parties favored the required steps, meant to secure the adhesion to the European Union, as well as the fact that the Romanian economy is defined by a high level of the privatization (about 70% of the total), which is limiting the influence of the actions initiated by the government.*

*Thereafter, I have developed, through a logical order conceived by the author, the main macroeconomic aspects, a particular emphasize being focused on: macroeconomic indicators, Gross Domestic Product evolution and its factors of influence (resources, utilizations, ownership form), foreign direct investment, inflation (consumer prices), industrial and agricultural production indices, investments in constructions, production of services, foreign trade, population and labor force, minimum net wage evolution.*

*The analysis has been performed on the basis of data as recorded by December 31<sup>st</sup>, 2006 while the comparisons have been, sometimes,*

*extended over the period 2001/2006, in order to let them be as suggestive as possible. Meantime, a number of developments have been presented also in a graphic or synthetic tables form, however without becoming abundant.*

**Key words:** Gross Domestic Product; foreign direct investment; inflation; unemployment; minimum net wage; population; labor force.

**REL Classification:** 3B, 10B, 20G



### 1. General framework

The 2006 year counted as the second one out of the four years mandate of the government coalition (the Alliance PNL-PD, Conservator Party, UDMR and the Independent Group of the National Minorities) which, despite the huge internal dissensions, tried to materialize in practice the necessary steps, as required by the adhesion to the European Union, for which it benefited of the parliament support since the program in this respect has been announced in November/December 2004.

Any interpretation, whatsoever, being done in this very moment in respect of certain evolutions would be, in the author's opinion, easily considered as favoring one or another direction.

Certainly, the general atmosphere governing the year 2006 cannot be ignored, as it is marked by the fact that the opposition acted more insistently in the footlights, quite concerned meantime to heal certain wounds being opened since 2005, by internal agitations and, mainly, by directing the power attacks towards PSD, with priority.

PSD had to face internal flows but managed to change, on the fly, its image passing to a more active opposition in the parliament, mainly by using the ordinary motions way (this is the case for justice, education, health, etc.) or by concertizing the anti-presidential opposition which get formed on the ground of the triangular fight – presidency, prime-minister and parliament.

At its turn, after proceeding to let's call them certain "purges", undertook a more vigorous activity on the parliament plan, its main concern consisting of sanctioning the more sensitive elements of the battle between the two palaces (Cotroceni și Victoria).

As far as the other side is concerned, the balance of forces within the Alliance PNL-PD kept on being reversed, with awakening ambitious, which sense the fact that the developments are not of the kind to justify



the algorithm established back in 2004. The internal fight between PNL and PD became sharper, mainly on the ground of the detachment of PLD out of the prime part of the Alliance DA.

Even after changing its name, from the Humanist Party, the Conservator Party kept on being considered, at least by the Democratic Party, as the “immoral solution” they have been obliged to resort to. After the adhesion, this party withdrew from the coalition and went thickening the opposition ranks, initiating a series of steps, along with other forces of the opposition, against the Presidential institution (the Parliament Commission for analyzing the President abuses, forcing the government reshuffle, etc.). It is indeed quite hard to say whether this party gets strengthen, weakened or kept its position but, for one thing, it is sure that it is concerned about introducing certain projects of law which until now did not take the advantage of the coalition acceptance (agreement), although some of them are included by the Parliament agenda.

UDMR kept on maintaining its leading direction i.e. promoting the Minorities Law, but limited its actions to a moderate walk on the way which is destined to them for any governing period which they have never missed so far.

On the ground of these disputes, the Parliament did not show a particular activity, the laws being passed consisting of approving or rejecting ordinances or emergency ordinances or legislating in the frame of certain fields concerning the implementation in practice of the governing programs.

After assuming its responsibility twice, for two packages of many laws, respectively package of laws concerning the justice reform and the package of laws concerning the health system in Romania, the Government faced the situation of being obliged to fight with some of the PD ministers (external affairs, justice, internal affairs) in order to keep the present formula as coagulated as possible.

The laws concerning the harmonization of the legislative framework from Romania with the one in force within the European Union, as well as the possibility of having certain alterations to certain laws previously adopted have been adopted without difficulties as all the parties, either from governing or from opposition, did subscribe to the adhesion of Romania to the European Union as from January 1<sup>st</sup>, 2007.

Under such circumstances, we may conclude that the government which reshuffled several times on the fly, kept on following the way of implementing and observing the legislative framework being required by the adhesion of Romania to the European Union, continued the program

taken over from the previous government and, eventually, excepting two uncontrollable objective situations, namely the floods without precedent in Romania and the very poor "performance" of the agriculture, mainly quality-wise, led to the expected outcomes recording, as a paradox, economic growth for almost all the fields of activity.

By the time these lines are written, there is a new government in place, a minority one PNL-UDMR, which is based by the parliament support, even if this can be fragile or at least sensitive any moment. The way this new government will passes the commissions, the Parliament (joint Chambers) and get the approval of the president is a process to follow before further trying to intuit which are the priorities it might consider.

Further amendments are further expected as regards the Fiscal Code, so that it lines up with the European standards, as well as rectifications of the consolidated budget, which allow certain requirements of the IMF to be met so that the negotiations are de-blocked and, under the circumstances, the "blank cheque" from this institution is granted, as Romania still needs it.

As far as the preparation and the integration of Romania in the European Union starting with January 1<sup>st</sup>, 2007 are concerned, here there is room to point out the fact that a program of steps meant to secure the necessary framework as well as to facilitate the implementation in practice of the post-adhesion actions is compulsory required.

Since for the year 2007 this issue is one of a vital importance for the evolution of Romania within the forthcoming years, I have dedicated a separate chapter in this respect, enabling these aspects to be presented in a way matching with everybody understanding.

After this short incursion which, I do believe, has no pointing to no lateral parties, let's revert to the way Romania is reflected in the figures, many of which bearing still a provisional character, which have been recorded for the year 2006.

## **2. The major statistical macroeconomic indicators**

The indicator the most synthetic for Romania, concerning the outcomes recorded in 2006, is given by the Gross Domestic Product which counted for 342,418 billion of lei, expressed in the current prices of the year 2006.

Based on this indicator, it results that the GDP/capita levelled 115.864,2 lei, which reflects a slight increase as comparatively to the previous periods.

GDP/capita, calculated on the basis of the purchasing power parity counted for 8.800 units standard purchasing parity, which represents the monetary unit of reference at the level of the European Union, as conventional currency which excludes the influences of the differences between the national prices.

The deficit of the foreign trade balance (export FOB/import CIF) counted for 14,9 billion of euro, as the highest one being recorded by the Romanian economy all over all times till now.

The situation occurring in this respect implies certain discussions which, briefly, may resume to the following basic aspects:

- The imports increased by 25,9% comparatively to the previous year due to the exchange rate recorded by the national currency, which kept on appreciating all over the year 2006 and keeps the same trend in 2007 as well. The imports became very profitable since, despite the significant appreciation of the national currency against Euro and USD, the wholesale and retail prices were not adjusted by cutting-off, the companies considering that they are a gained position which is not advisable to give up;

- On the other side, the exports increased slower (+16,3% comparatively to 2005), because the fact that this modified position of the exchange rate against the two currencies of the foreign exchange panel of reference has been a disadvantage, the domestic production becoming much more expensive for the export which, consequently, diminished;

- The increase by 14,9 billion Euro of the commercial deficit is by far too large, adding the consolidated deficit recorded by Romania to the foreign debt of the country;

- Normally, one country deficit, including the Romania one, is not alarming to the extent it makes part of a program of external loans, directed by projects which do not harm the national wealth;

- In the context of the imports propensity towards the consumer goods, the situation can be evaluated as a negative one.

Nevertheless, we have to note that these are the data which, voluntarily or not, led to such a situation.

### 3. The Gross Domestic Product evolution

In 2006, the estimated GDP counts for 342,418 billion lei, meaning an increase of 7.7% comparatively to the outcome of the year 2005.

Here we have to note that this increase has been affected by the reduced contribution of the agriculture, counting for 0.3% only.

The level of the GDP increase in 2004, namely 8.4%, has been equalized to a certain extent, but it is hard to forecast it for the forthcoming period, mainly for the first post-adhesion to the European Union years, when a lot of adjustments are required, without depending on the will or on the actual situation in our country only but on the European Union policy of harmonization as well.

The Gross Domestic Product per habitant recorded an increase of 14.8% as comparatively to 2005, which is significant for the level of Romania.

If comparing the GDP increase level with some other countries out of the European Union, we shall see that, without any exception, this was the highest rate of growth within this group of states (UE-25 recorded 2.9%) .

Thus, the Netherlands recorded an increase of 2.9% only, Belgium 3.1%, Germany 2.7%, Italy is recording an increase of 1.9%, Finland 4.4%, the United Kingdom of Great Britain and North Ireland 2.7%, Denmark 3.2%, and on the overall basis of the European Union (the 25 countries), the average index of the GDP increase leveled up to 2.9%.

If inserting it into this series of data, we can see that Romania is placed on the top position as for the GDP increase level.

- **The GDP increase factors by categories of resources**

In 2006 the GDP has been achieved on the account of the activity carried out in the frame of the main branches of the national economy.

However, their contribution differed from the point of view of the gross added value recorded at the level of each branch. The net tax on product brought a contribution of growth counting 0.9%, services activity contributed with 3.6%, constructions with 1.2% and industry with 1.7%.

The contribution of the agriculture, forestry and fish breeding was lower, counting for 0.3% only.

By categories of resources, the Gross Domestic Product has been achieved by the contribution of the developments recorded within the following branches: agriculture with an increase of 3.3%; industry with an increase of 6.9%; constructions with an increase of 19.4%; services with

an increase of 7.3%. On an overall basis, the gross added value recorded an increase of 7.7%, while the net taxes on product increased by 7.9%. Hence, we can state that achievement of the Gross Domestic Product is due to the positive influence of all branches of the national economy.

The activities carried out by services, industry and constructions, together, brought a contribution of 80.5% to the GDP forming which means a positive feature for the Romanian economy under the circumstances of its restructuring process involving the need of giving up a number of industrial along with the commitment on the way of developing the services production, constructions and so on, which element has to be considered as such.

- **The GDP achievement by categories of utilizations**

From the point of view of the “utilizations” in 2006 the GDP has been achieved by the contribution of: the stocks variation, the net export, the gross forming of fixed capital, the final collective consumption of the public administration, the final individual consumption of the households.

When analyzing the data available for 2006, we have to consider as starting point the actual situation being recorded by our country during this year.

Thus, for instance, the stocks variations recorded a contribution of 0.3% while the net export, namely the difference between exports and imports, recorded a negative effect, counting for -6.4%.

Under such circumstances, we find that, from the point of view of the utilizations, the GDP has been achieved by the contribution of the following factors: gross forming of the fixed capital by 3.7%, final collective consumption of the public administration by 0.2%, final individual consumption of households by an increase 9.9%, which implies the following conclusions:

- From the point of view of utilizations, positive influences on the GDP achievement have been recorded by the final individual consumption of households, the final collective consumption of the public administration and the gross forming of fixed capital;
- Negative influences on the GDP forming have been recorded as to the net export and stocks variation which generated a depreciation of -6.4%.

The analysis of the influence factors of the GDP increase by categories of utilizations may be emphasized within this chapter by the

analysis of rhythm at which the categories of utilizations considered for the GDP achievement increased in 2006, as comparatively to 2005.

Thus, the actual final product, namely the final individual consumption of households and the final collective consumption of the public administration together increased by 11.5%.

A more marked increase, counting for 12.6%, has been recorded by the final individual consumption of households while the final collective consumption of the public administration increased by 2.7% only.

Another positive contribution has been brought by the rhythm of increasing recorded by the gross forming of fixed capital, respectively 16.1%.

If one considers the field of external economic exchanges, the evolution shows that the export of goods and services recorded an upwarding rhythm, increasing by 10.6% as comparatively to the previous year while the imports of goods and services increased by far more rapidly, by 23.0% which led to the unbalancing of the external commercial balance, involving an immediate effect of consumption counting for 6.4% of GDP, which has been offset on the account of the other factors (utilizations).

Out of the analysis of the overall data, it is to note the fact that the domestic demand for goods and services increased by 12.8% during the year taken into account.

#### • **The GDP achievement by ownership forms**

Out of the performed analysis, it is resulting that as far as 2006 is concerned, even if data are still provisional, the private sector contributed with 69.8% to the GDP forming. The decrease of the weight of the private sector has been generated mainly by the gross added value in the agriculture. Such an influence is a normal one if we consider that in 2006 too the agriculture has to face negative natural conditions.

If comparing the weight of the private sector in the GDP achievement with the figures recorded for the previous periods, we find out that this weight is lower comparatively to the year 2005 (71.5%) but superior to all the periods being analyzed as from the year 2000, even as from the year 1990, up to date.

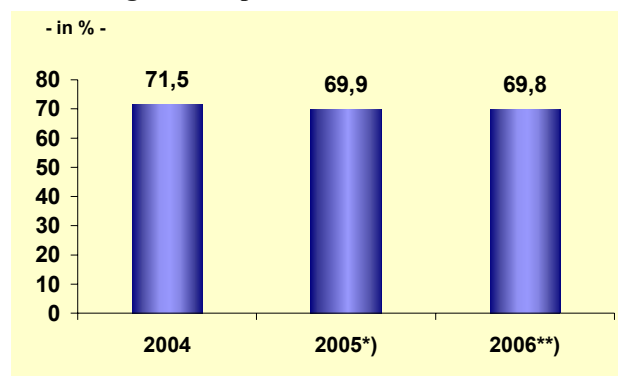
During the year under analysis, 2006, we find that the weight of the public sector in the gross added value increased as for the constructions field, as a consequence of the process of repairing the infrastructure and the houses being damaged by floods, a process which was financed from the state

budget. Therefore, the private sector which plays a smaller part in this field had a smaller influence on the GDP forming.

What is really important is the fact that the up-warding rhythm of the increase recorded as to the weight of the private sector in the achievement of the gross added value, by branches of the national economy and, eventually, to the GDP forming, kept on maintaining and get even more pronounced. There is still a weight of 30.2% which must be considered as an element of valorization during the forthcoming periods. In this respect, it is obvious that the privatization of other branches of activity or extending the privatization at the level of branches already privatized will have the targeted effect.

Here we have to underline the fact that such an analysis is not always pertinent since there will be and remain sectors of activity absolutely important for the national economy for which the state must keep its attributes of sole owner.

**- weight of the private sector in 2003 - 2005 -**



\* Semi-final data. \*\* Provisional data

**Figure 1. Gross Domestic Product**

#### **4. Direct foreign investments**

2006 was a year when a series of sectors of activity kept on getting privatized while those already privatized kept on increasing their patrimony (capitals) by attracting new autochthonous and foreign investments which, from the point of view of the effects on the national economy structure, is an important aspect to consider.

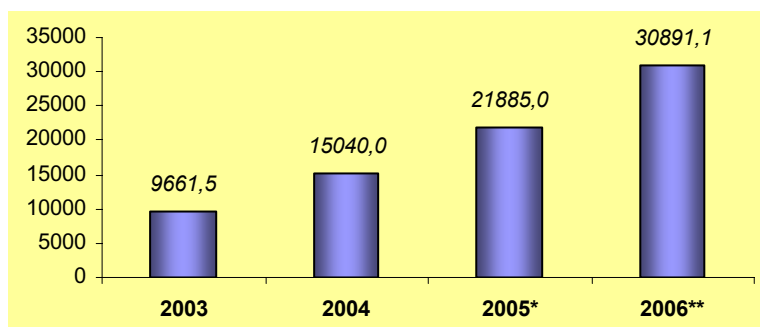
The direct foreign investment increased rapidly during 2006, on the expenses of the setting up new companies with foreign participation, the increase of the social capitals other items at the level of the already existing companies or by means of privatizing, with foreign participation, important sectors of activity.

Under the circumstances, according to the data provided by the RNB, it is remarked that in 2006 the total value of the direct foreign investment in Romania reached the level of 30.8911 billion euro. This level means an increase of more than 9 billion Euro, comparatively to the previous year which is a very important aspect to consider. Out of this amount, a sum of 3.75 billion Euro has been generated by the privatization process of the Romanian Commercial Bank.

Thus, the direct foreign investment in Romania increased in 2006 by 41.2% as comparatively to 2005.

In 2006, 76.2% of the direct foreign investment was placed in the sector of "participations to capital", 23.8% only being placed with the sector "other capitals".

Meantime, by the end of 2006, the direct investment of the Romanian residents abroad counted for 210.9 billion Euro, this being the contribution evaluated by the documentary system available in the country.



\* Revised data. \*\* Provisional data.

Data source: RNB.

**Figure 2.** *Direct foreign investment (ISD) in 2003-2005*



### **5. The inflation (consumer prices) evolution**

An important element to consider when evaluating the economic evolution of a country over a period of time consists of the way the consumer prices developed, both on an overall basis and by groups of goods and services, as well as of the dual comparison with the planned, forecasted target and the outcomes of the previous year.

In the context of the steady concern as regards the adjustment of the system of the income collecting, based on the unique quota of taxation, as well as bringing the Fiscal Code to the level of correlative terms, in line with the actual situation of the country, in 2006 there are a number of events occurring and worth to underline.

- First of all, the successive discussions without, as we may say, a final aim, between the Romanian Government and the IMF, get blocked because of the different way of understanding on the subject of conceiving and letting work the state budget and, to an extended meaning, the consolidated budget. There were a number of elements which the IMF, intransigent and willing to see a market economy in action, did not agree with. Thus, for instance, there were many concerns in respect of how to convince the IMF to agree with a deficit of up to 2% of GDP or to keep on accepting the situation of having certain subsidies at the level of the national economy.

On the other hand, having in mind to keep on observing their electoral promises, the governing coalition did not agree with the IMF suggestion as regards the rating of some increased taxes as a mean to support the additional collecting of incomes. There were two alternatives to consider in this respect: either the increase of the VAT quota, at least for a part of goods and services if not for all of them, or the increase of the unique quota of taxation by several percentages or even the enforcement of other taxes as a last alternative.

The governing coalition has undertaken the responsibility to keep on acting according to the exercise conceived during the electoral campaign and proposed as governing program even though inside the coalition there were certain parties, such as the Conservator one, which had asked for the decrease of the VAT quota for certain goods of daily consumption and utility, so that a “disagreement”, at least for a period of time, did exist between the parties in dispute.

For the time being, let's say that the issue consisted of the adjournment of those “stand-by” agreements being accepted only once since 1990 up to now and let's hope that the situation may be recovered.

- The second significant phenomenon of the year 2006 is given by the divergent evolution between the consumer price index, as an overall and in structure, in comparison with the evolution and appreciation of the national currency, leu, against the two currencies which are forming the foreign exchange basket, respectively Euro and USD.

Since a couple of years, as a consequence of the RNB policy, which undertook the responsibility of targeting and fixing the inflation at certain levels, the foreign exchange evolution followed a trajectory which, from a economic and financial point of view, proved to be a positive one but, meantime, generated a disastrous effect on the Romanian exports, on those working abroad and those living in the country, being meantime non-conform with the actual economical situation of the country.

On this ground, we are facing a significant appreciation of the national currency, in contrast with the increase recorded by the inflation rate, on the overall basis and in its structure by goods and services.

- Another essential element arising in 2006 is given by the finalization of the process to implement the currency (leu) denomination. The theory teaches us that an important factor as regards the evaluation of the way the inflation is developing consists of the monetary mass in circulation.

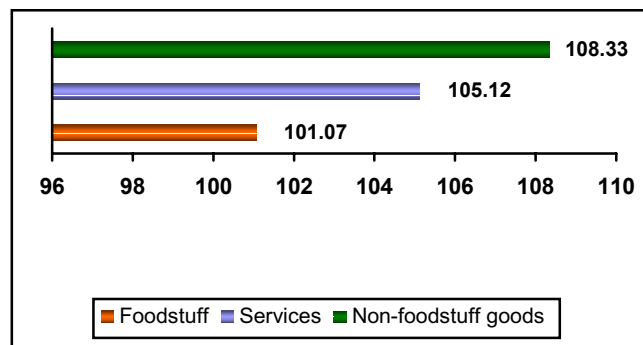
There are two contradictory evolutions which we could identify from this point of view. On the one side, the increase of the consumption propensity of the population and, hence, the imperative requirement for steps meant to stop this tendency. Thus, at a first stage, the interests for the population deposits have been reduced after which, in order to improve the attractiveness of saving, they have been increased aiming a sole purpose, respectively tempering the population propensity to consumption.

On the other hand, the concern as to targeting the inflation and, to a certain extent, a certain fetishism concerning the actual evolution of the inflation, circumscribed also the too large delay of taking out of circulation the old coupure and introducing instead the new one. Normally, this process should have been much shorter, if considering that everything getting out of the banking system for outside purposes (individuals and juridical entities) had to consist of the new currency while everything withdrawn by the system of market transactions had to be stocked and withdrawn from circulation.

Under the terms of such an analysis, there can be mistakes to be considered but there is also the possibility of believing that the tangible

monetary mass existing in the market was somehow larger, being actually known by the National Bank only.

That's why, the denomination process, otherwise efficient and well built up, might have hidden and justify the difference between the foreign exchange rate, achieved mostly by steps of the management strategy of the National Bank, instead of being a result of the harmonized economy in action.



**Figure 3.** *The evolution of the consumer prices on an overall basis and on goods and services groups, in 2006 comparatively to 2005 – in %*

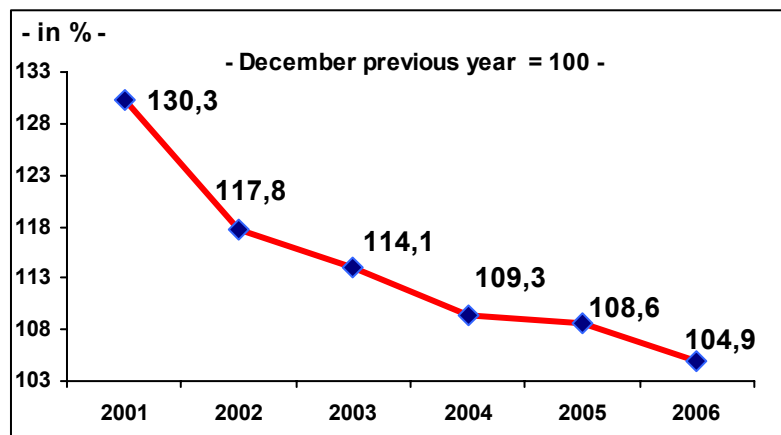
- Another element, typical for the year 2006, is given by the steady concern of the Executive and, mainly, of the National Bank to observe the goals declared as regards the inflation targeting, which lined up with the forecasted level although this targeting slipped out of an actual control on several occasions, eventually ending as 4.9% in 2006 as comparatively to 2005.

On the ground of all these events which, along with a number of others, are working out to impose the rhythm of the inflation rate increase, we have to remind the fact that this indicator is calculated for three large groups of goods and services, respectively: foodstuffs, which recorded an increase of 1.1%; non-foodstuffs goods, recording an increase of 8.3%, and services, recording an increase of 5.12%.

The 4.9% rate of increase is a result of the weight taken into consideration on the basis of the relationship between the relative proportions.

Another possible analysis on the increase of the consumer price index might take into consideration the influences of the administrated prices which recorded an average increase of 2.98%.

If proceeding to a careful analysis, we should note also that there are only three-four groups of goods which recorded a particular increase and generated the impossibility of hitting the forecasted target. Thus, for instance, the consumer taxes (taxes on vice), respectively the excises on alcohol and tobacco products, as well as luxury goods or products such as natural gas or thermo-energy, have been extremely high, having a major influence on the rhythm of increase of the consumer price index (inflation).



**Figure 4.** Consumer price indices within the period 2001-2006

From the point of view of the average monthly rate, the recorded increase counted for 0.4% on an overall basis while when talking in terms of structure of the three elements of calculation, it counted for 0.1% for foodstuffs, 0.7% for non-foodstuff goods and 0.4% for services.

At this point, there are a lot of other comments to be done but for a synthetic picture of the consumer price index we are focusing on the present analysis only.

Taking into account the fact that Romania became a member of the European Union as from January 1<sup>st</sup>, 2007, it is compulsory to approach also the subject of the evolution of the consumer price index as against the same index recorded at the level of the community of the 27 states. Out of the data available from EUROSTAT, it can be noted that

there is only Bulgaria recording a higher rate of inflation (7.4%) than our country while Lithuania recorded a position similar to the level recorded by our country (6.6%).

### **6. The industrial production indices**

In 2006, the industrial production indices are reflecting an increase of 7.1% as comparatively to the previous year, being largely influenced by the restructuring of the extractive sector, as well as by the decrease recorded at the level of the lohn production, which generated a slower rhythm of development at the level of the manufacturing industry.

The rhythms of increase in the industrial field differed, with increases recorded by certain categories such as the industry of durable goods, recording an increase of 23.5%, the industry of capital goods with 10.6%, the processing industry with 7.8%, the industry of current usage goods with 8.1%, thermo and electric energy with 4.4% and other industrial branches.

The fact that these other activities or branches had small weights within the total industrial activity from our country is to be noted.

However, there are several other branches which recorded diminished indices, such as: textile production, clothes, shoes and leather articles production, rubber and plastics products, production of building materials and other non-metallic minerals and production of equipments and machinery.

The first three categories, i.e. textile production, clothes, shoes and leather articles, carried out their activity in the form of lohn production and recorded a tempering rhythm which might generate effects during the periods to come.

On an overall basis, the industry kept on remaining on a positive position, whereof its contribution of 1.7% at the achievement of the GDP.

The privatization process could lead within the forthcoming periods to new decreases, both for the rhythm and the volume of the production of certain branches, but also of the total contribution which the industry might bring to the GDP achievement, by the obtained gross added value.

The labor productivity by an employee in the industrial field increased in 2006 as comparatively to 2005 with a rhythm which represents less than half the increase of the labor productivity being achieved in 2005 as comparatively to the previous year.

In 2006, the total of the resources of prime energy amounted 41.9513 million tons equivalent crude oil, out of which from the domestic

production 24.5912 million tons equivalent crude oil and from import 17.3601 million tons equivalent crude oil.

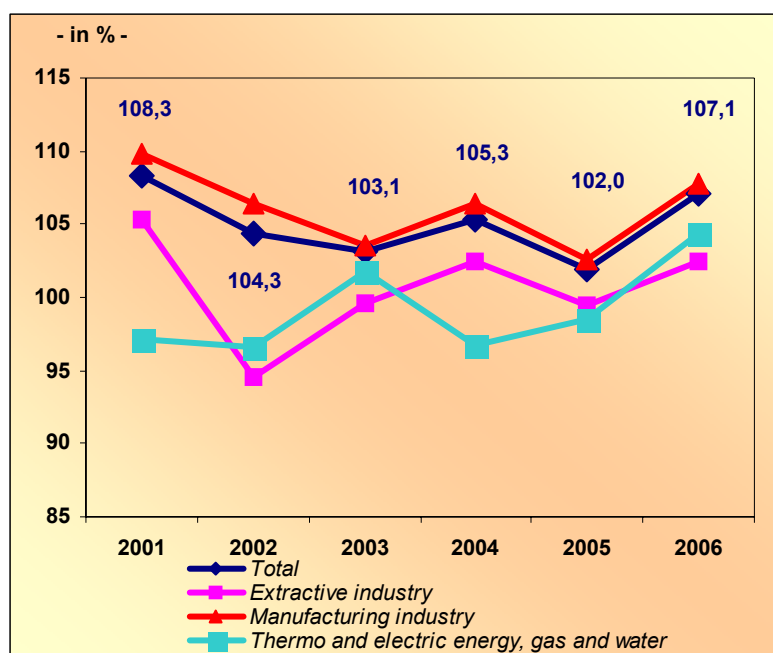


Figure 5. The total prime energy resources

In December 2006, the prices of the industrial production increased by 0.4% as comparatively to the previous month.

The extractive industry recorded an increase of prices counting for 3.8% as comparatively to November 2006, due increased prices for hydrocarbons extraction and connected services (+ 6.0%)

The manufacturing industry (-0.3%) recorded slightly diminished prices for the majority of the branches, the most significant one being recorded in (-3.5%), equipments, radio and television sets and communications (-2.7%) and metallic constructions and metal products (-1.1%).

Comparatively to December 2005, in December 2006, the industrial production recorded an increase of 3.9%.

As far as the *manufacturing industry* is concerned, more significant increases have been recorded by the following branches: production building materials and other products of non-metallic (+34.6%), equipments, radio and television sets and communications (+34.0%), conveyance means non-included to road transport means (+30.6%), medical apparatus and instruments, precision and optical instruments and clocks and watches (+22.0%), road transport means (+20.2%), metallic constructions and metal constructions (+17.6%), pulp, paper and paper products (+14.5%) and foodstuffs and beverages (+14.4%). Within the *manufacturing industry* also, there are branches recording decreases, such as: oil processing, charcoal coking and nuclear combustibles treatment (-26.3%), electric machinery and apparatus (-18.5%), clothes (-16.8%) and printing activities, polygraphs reproduction of recording on holders (-16.3%).

When talking about the large industrial groups, the highest increases have been recorded by the durable goods industry (+20.0%), the capital goods industry (+15.1%) and the intermediary goods industry (+5.2%).

In December 2006, the *total turnover figure* of the industrial units was by 6.1% higher as comparatively to December 2005, higher increases being recorded by the capital goods industry (+14.5%), durable goods industry (+9.5%) and the intermediary goods industry (+8.6%).

*The value of new orders* within the branches of the manufacturing industry carrying out their activity on orders basis, amounted, in December 2006, 10132 million lei (RON), the highest values being recorded by the intermediary goods industry, 4113 million lei (RON), followed by the capital goods industry, 2888 million lei (RON), while the durable goods industry recorded the lowest value, respectively, 534 million lei (RON).

*The brut series of the indices in 2006 comparatively to the year 2005, indicates the fact that the industrial production was higher by 7.1%*, this increase being sustained by all three sectors of the industry: manufacturing industry (+7.8%), thermo and electric energy, gas and water (+4.4%) and extractive industry (+2.4%).

The biggest increases have been recorded by branches of important weights (Anghelache, 2006) of the manufacturing industry: furniture and other industrial activities non-classified otherwise (+21.2%), road transport means (+21.2%), conveyance means other than the road transport means (+16.3%), foodstuffs and beverages (+15.9%), metallic construction and metal products (+15.8%), chemical substances and

products(+14.0%), building materials and other non-metallic minerals products manufacturing (+11.8%), electric machinery and apparatus (+11.6%). The impact of the significant increases mentioned above, on the overall increase of the manufacturing industry (+7.8%), has been blurred by the decreases recorded by other sectors of the manufacturing industry, such as: textiles (-13.1%), tobacco products (-9.3%), clothes (-8.9%), precision and optical instruments and clocks and watches (-5.8%), equipments, radio and television sets and communications (-5.7%).

As for the large industrial groups, the most important increases have been recorded by the durable goods industry (+23.5%), the capital goods industry (+10.6%) and the intermediary goods industry (+8.1%).

*As comparatively to 2005, in 2006 the increase of the turnover figure (Anghelache, 2007) on the overall industry counted for 6.1%, which increase reflects the contribution of the capital goods industry(+16.6%), the durable goods industry (+9.1%), the intermediary goods industry (+6.2%) and the energetic industry (+4.6%).*

*The labor productivity in industry recorded an increase of 10.6% in 2006 as comparatively to the year 2005, increase that has been influenced by the productivity dynamics within all the sectors of activity: extractive industry (+25.2%), manufacturing industry (+10.2%) and thermo and electric energy, gas and water (+5.1%).*

*In 2006, the main resources of prime energy amounted 41951.3 thousands tons crude oil equivalent (Anghelache, 2006) (of which, 24591.2 thousands tons crude oil equivalent from the domestic production), increasing by 1.1% as comparatively to 2005, as a consequence of the increase of imports by 3.1%. The production of prime energy decreased by 0.3%.*

## **7. The production indices in agriculture**

2006 meant a year of low crops as far as the vegetal production of almost all the cultures is concerned.

Thus, the grains crop recorded 15.352 million tons, with a significant decrease as comparatively the year 2005 but comparatively acceptable is considering the years 2002 and 2003.

The potato production counted for 4.251 million tons, the sunflower one counted for 1.605 million tons, vegetable 4.520 million tons, fruit 1.312 million tons and grapes 0.948 million tons.



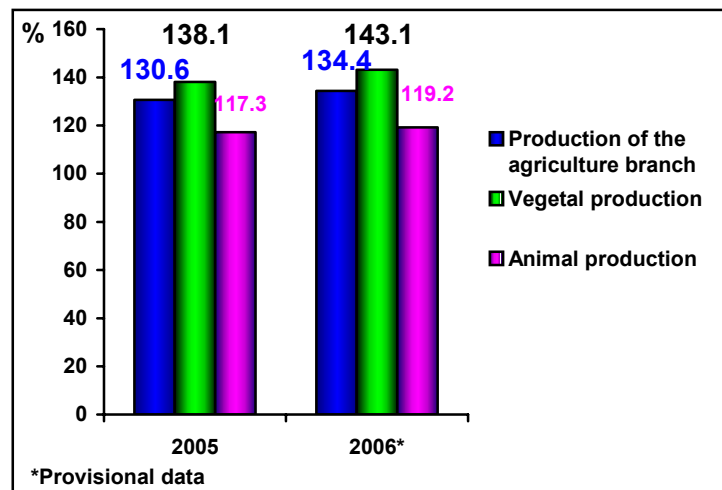


Figure 6. Production indexes for agriculture

The most dramatic decrease as comparatively to the previous years has been recorded by the viticulture sector, where the production counted for 948 thousands tons only.

Of course, the analysis of the agricultural production has to take into consideration the fact that 2004 counted as the year of the highest production over the last 15 years, despite the fact that the quality has been questionable.

As far as this last aspect is concerned, we have to take into account the fact that large cultivated surfaces have been flooded and thus the crops have been compromised. This is actually the very objective factor which let the agricultural production be maintained to a low level, quantity and quality wise.

However, there is also a subjective factor to consider in this respect, namely the fact that under the specific climatic conditions cropping up during the year which we are analyzing, the small farmers have shown little interest as regards their specific daily activity.

The fact that on the overall agricultural activity is recording a new decrease in 2006 is to be noted.

The live stocks recorded increases so that the following figures have been reported for 2006: 2.925 million bovines, 6.905 million

porcine, but as far as the ovine sector is concerned (7.584 million), there is a decrease to consider.

In this field, there is the private ownership of the peasant households or even of urban households (mainly small towns), which is predominant and recording increases.

Apart the poor crops and agricultural productions being recorded in 2006, there is another negative element to consider, namely the poor quality of the production. This is due mainly to the fact that the labor of the soil is critically performed, the irrigation system is operational only in case there are surfaces large enough to allow it, the draught and the rains do not coordinate with each other, to the extent that there have been large periods of the year characterized by unusual precipitations along with other similar periods of heavy draught, when the lack of the irrigation system materialized in disastrous consequences.

On the other hand, splitting the land into small parcels and lack of any crop rotation whatsoever, lack of a proper quality seed as a general feature, are the factors counting as determinants for both the poor crops and their poor quality.

### **8. Investments in constructions**

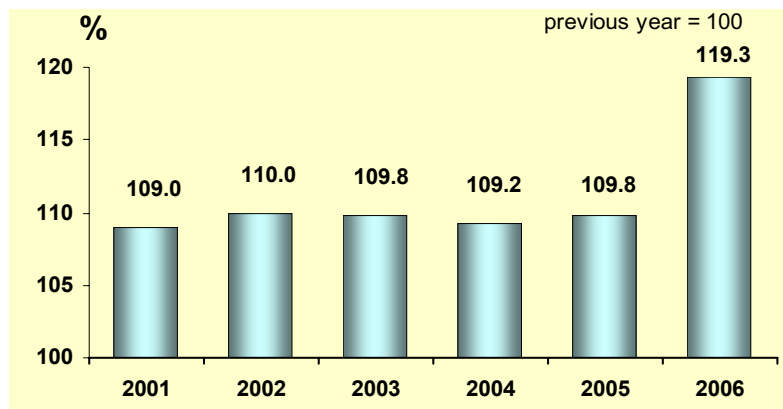
When analyzing the outcomes achieved by Romania in 2006, we find out that, on an overall basis, the investment recorded a rate of increase of 16.1% against the previous year, out of which the investment for equipments and conveyance means recorded an increase of 11.2% and new construction works recorded an increase of 18.0%.

From the point of view of their destination, the investment directed to the industrial sector in 2006 meant mainly the replacement of the old equipments, the increase of the production capacity, technologies modernization, environment protection, labor protection and investments to other sectors.

The imports of capital goods, representing about 17.5% of the total imports, increased by 35.9% in 2006 as comparatively to 2005. This means that the completion of the capital goods has been achieved, insuring thus the increase, by capitalization, of the companies assets.

As regards the construction works, the year 2006 shows that their volume increased by 19.3% as comparatively to the previous year. This is actually the rhythm which has been recorded during the previous years as well. In 2006, there have been 38,178 newly finalized houses being built

up, out of which a number of 1,898 meant to be allocated to the victims of the disaster, respectively the floods.



**Figure 7.** Construction works evolution during 2001-2006 period

To note also that 33,409 out of these constructions have been achieved by integrally private funds.

As far as the structure of the buildings is concerned, the figures show that the engineering construction objectives recorded an increase rhythm of 21.8% while the residential buildings recorded an increase of 16.2% only. A significant increase has been recorded in the field of getting the construction authorizations, which counted for 51,059, meaning an increase of over 17% as comparatively to 2005.

By December 31st, 2006, the construction works presented various stages of achievement, which actually secures an important working front for the year 2007.

### 9. Production of service

Comparatively to the year 2005, in 2006 the indices of the market services supplied to the population have recorded an increase of 13.6% while the indices of the retail trade increased by 24.0%.

This increase is generated by the domestic demand (an element of the GDP utilization), which increased by 2.8%, i.e. over 1.5 times higher than the actual GDP growth.

Meantime, the services reached a weight of over 50% in the GDP, out of which the retail trade only recorded an increase 21.5%.

The services contribution to the GDP achievement by the gross added value achieved in the frame of this sector means a positive development which, at this stage of the integration, means a lot for Romania.

Out of the analysis of the structure of the carried out services activities, we note the fact that the retail trade activity recorded particular rhythms of increase. Thus, the trade with foodstuffs, beverage and tobacco is recording an increase of 27.7% while the trade with non-foodstuffs increased by 21.1%.

The activity of sales by correspondence and virtual shops get developed so that this filed records an increase of 56.8% in 2006, as comparatively to the previous period.

The dynamics of the services carried out to the population has been supported mainly by the activity of hotels and restaurants, which recorded an increase of 12.0%

Briefly, 2006 is a significant year as far as the production of services is concerned, by the following major guide marks:

- The steady increase of the weight services hold as for the GDP achievement ;
- The structural balancing of the services carried out to the population;
- Differentiated increases, for certain fields as already mentioned, quite significant, of the production of services spread on various zones, meaning actually a real concern for the development of the production of services;
- The employment of a large number of persons in activities of carried out services, which tendency should mark a similar evolution during the forthcoming period;
- The qualitative improvement of the services carried out to the population;
- The development of hotel activities which meant a better level of occupying the hotels and a higher contribution to the GDP achievement;
- Closing up to a weight of 50% of the contribution which the production of services brings to the GDP achievement (for a number of developed countries such as Sweden, Switzerland, etc., the carried out services contribute with over 70% to the GDP achievement);

- There has been a development of the financial and banking services as well as of capital market service, including thus a series of employees.

Another aspect concerning the analysis in the field of the production of services in our country is given by the volume of the turnover figure achieved by the wholesale and retail trade of auto-vehicles, the retail trade with fuel etc. As comparatively the year 2005, in 2006 this field of activity recorded an increase of 18%. During the year 2006, a number of 322,263 auto-vehicles, both new and second-hand, have been registered while the turnover figure recorded by the IMMs represented 79.3% of the total retail trade (downwards as against 2005 – 82.4%)

Here we have another element which denotes a positive evolution of the activity run in the field of the production of services in our country.

Generally speaking, the turnover figure increased for all sectors of activity, with a realistic premise to have a similar trend being recorded in 2007 as well.

As for the international tourism, in 2006 the number of foreign visitors coming in Romania increased by 3.4% as comparatively to the previous year. There have been 6.037 million visits from abroad in our country. Basically, the persons having friendship or kinship connections in Romania intensified their visits here. In this respect, the most numerous visits have been paid by citizen from Germany, United States, Israel, France, Republic of Moldova as well as from other countries where there is a significant number of Romanian natives.

During the year we are analyzing, the departures of the Romanian visitors abroad reached the level of 8.9058 million persons, which means an increase of 24.7% as comparatively to 2005.

Here again we find out an increase of the interest of persons from Romania as to travel abroad and it is not hard to anticipate that, after the adhesion, by having the provisions regarding the free circulation of persons within the territory of other states of the community well in place, the number of persons paying visits to other countries will increase.

In 2006, 83.3% of the trips abroad have been achieved by personal conveyance means, as tourism visits and trips abroad. The air traffic of passengers recorded also a sudden change for the better, with an increase of 26.7% as comparatively to the previous period.

## **10. The foreign trade**

In 2006, the foreign trade recorded a dual evolution, i.e.: on the one side, the volume of both imports and exports grew up rapidly, which is a positive fact.

The dualism consists on the fact that, this time again, the imports have exceeded the exports increase rhythm, resulting in an impressive deficit of the trade balance. Thus, while the exports of goods, on a FOB basis recorded an increase rhythm of 16.2%, the imports of goods, on CIF basis recorded a rhythm of 25.1%.

As absolute figures, the imports amounted 25.85 billion Euro, i.e., by 3.59 billion Euro more as comparatively to the previous year, while the exports amounted 8.18 billion Euro, i.e., by 4.075 billion Euro more as comparatively to 2005.

Under the circumstances, the sold of the foreign trade activity (the deficit of the trade balance) counted for 14.8953 billion Euro. Of course, this is a very particular increase which obliges us to carefully consider what is going to happen in case there are no proper steps taken in order to temper the imports and stimulate the exports meantime. Anyhow, since January 1<sup>st</sup>, 2007 when Romania has been accepted in the European Union, this evolution has to have a different significance.

In 2006, the trade deficit counted as 15.3% of the achieved GDP or, otherwise, 15.3% of the GDP being achieved by the Romania efforts had to be paid for additional imports, this implying the increase of the foreign debt or, if so wished, the increase of the internal debt, depending on the angle this issue is analyzed.

In 2006, the exports of Romania where directed at the level of 67.8% to the European Union countries (25 countries), which means an increase of 16.3% as comparatively to 2005.

At their turn, the imports from the European Union countries counted for 62.6%, meaning an increase of 25.9% as comparatively to the previous period.

In 2006, the foreign trade, import and export, was structurally different. Thus, from exports point of view, the structure consisted of: industrial supplies 35.2%; consumer goods 27%; capital goods, 12.5%; transport equipments, 12.2%; fuel and lubricants, 10.0%; foodstuffs and beverage 2.9%; otherwise non-specified goods 0.1%.

A remark is to note as for the first group of goods, i.e. clothes, tissues, knitted-ware and textile materials, most of them have been worked out on a Lohn basis.

From the imports point of view, the main weights went to: industrial supplies 35.0%; capital goods, 21.9%; fuel and lubricants, 13.3%; transport equipments, 12.9%; consumer goods 12.1%; foodstuffs and beverage 4.7%; otherwise non-specified goods 0.1%.

The positive aspect to note here consists of the fact that the imports of industrial supplies, capital goods and transport equipments counted for 69.8% of the total imports.

From the point of view of the way the imports and the exports have been achieved by the three groups (defined, depending on the processing level, as after active processing, for passive processing), the structure has been as follows:

- As to export: final exports – 50.8%; exports after active processing – 48.8% and exports for passive processing – 0.4%;
- As to import: final imports – 75.2%; imports for active processing – 23% and imports after passive processing – 1.8%.

Here there is a first comment to make, respectively, the final imports exceeded the final exports by almost 25%, while the exports for active processing, namely the processing performed abroad, involving the employment of foreign labor force, have been more than double as comparatively to the active processing, namely the imports achieved with the purpose of continuing the processing in the country in order to export them afterwards.

These two elements are usually encountered in the case of countries of low level of development.

From the point of view of the weight of the main groups of goods out of the combined Classified List, in the overall export operations for active processing, the main weights went to: clothes articles made out of knitted and crocheted, textile materials, mechanical equipments and machinery, electric apparatus for recording and reproducing sound and images, shoes and similar items, conveyance means and materials, metallurgical products.

On an overall basis, we can appreciate that the foreign trade activity did develop positively from the point of view of the volume but negatively if to consider the two components, import and export.

The decrease of the exports along with an exaggerated increase of the imports has been stimulated also by the appreciation of the national currency within 2006. On this ground, the positive element of the appreciation of leu implies a negative effect on the exports. Many of the

exporters either tempered their activities, or recorded modest gains to the best, if not pure losses.

Another element which generated a slower rhythm of evolution of the exports as comparatively to the imports consists of the fact that the process of privatization and restructuring involved the closing-up of a number of companies or autonomous State supervised administrations, as well as of the fact that the quality of the manufactured products was not in the position to meet the foreign customers requirements.

The imports and exports structure, according to the manufacturing stages, has been dominated by the intermediary goods, followed by the consumer and capital goods.

The main weight within the imports is hold by the imports from Germany (15.2%), Italy (14.6%), Russian Federation (7.9%), France (6.5%), and Turkey (5%), while as far as the exports are concerned, the first five places went to Italy (17.9%), Germany (15.7%), Turkey (7.7%), France (7.5%) and Hungary (4.9%).

The analysis of the energetic balance, in comparison with the deficit of the trade balance, underlines a deficit of the energetic balance counting for 21% of the trade balance deficit.

Hence, Romania is a net exporter of mineral oil products and electric energy and, meantime, a net importer of natural gas, crude oil and mineral fuels.

### **11. The population and the labor force**

By July 1<sup>st</sup>, 2006, the total population of Romania counted for 21,584,000 persons out of which, 10,521,000 males and 11,063,000 females.

For this period, there is an increase of the females number as comparatively to the number of male population to be underlined. The reasons for such a situation are based on three elements: the massive emigration of male population, the weight of the births favorable to the female population, and a similar ratio in terms of deceases.

The active population recorded in 2006, a number of 10.027 million persons, out of which, 5.505 million males and 4.522 million females.

Out of this population, the occupied population counted for 9.309 million persons, of which, 5.066 million males and 4.243 million females.

The number of unemployed persons, according to the BIM system, recorded the level of 184,000, of which, 439,000 males and 279,000 females.



According to data base of the National Agency for Employment of Romania, the number of unemployed persons recorded in 2006 counted for 460,495 persons, lower as comparatively the previous years. Out of this number, 191.449 persons were females.

From the point of view of the training level, we find out that 369.808 unemployed persons have a primary, gymnasium or vocational training, 141,343 persons out of them being females.

A number of 73,197 persons, of which 40,033 females, had a lyceum or post-lyceum training while a number of 17,490 persons, of which 10,073 females, had an university degree.

The unemployment allocation, as a monthly average, leveled to 247 lei, while the professional integration allocation counted for 163 lei.

Of course, this professional integration allocation included also the unemployment allocation granted to graduates of the university education institutes in accordance with the provision of the Law no. 76/2002.

As to the activity, employment and unemployment rates, computed according to the BIM system (computed against the population in age of 15-64 years), they are the following:

- Activity rate counted for 63.6% on an overall basis, respectively 70.5% for males and 56.7% for females; there is an increase of the employment, both on an overall basis and the two sexes, counting for 1.2% as comparatively to the previous year;
- Employment rate counted for 58.8%, 1.1% higher as comparatively to the previous year, while recording an increase of 64.6% for males and a decrease of 53% for females;
- Unemployment rate, computed according to the same BIM system, counted for 7.2%, respectively 8% for males and 6.2% for females.

The harmonized unemployment rate, as calculated by EUROSTAT for Romania, counted for 7.4% in 2006, as comparatively to 7.2% in 2005; the level thus recorded by our country is below the one recorded by the European Union (27 states), respectively 7.9%.

Meantime, out of the documents published by EUROSTAT for the year 2006, we can see that Romania recorded an unemployment rate which was lower as comparatively to other nine countries of the European Union (Poland – 19%, Slovakia – 13.3%, Bulgaria – 8.9%, France 9%, Belgium – 8.3%, Germany – 8.4%, Spain – 8.6%, Hungary – 7.5%, Finland – 7.7%)

The data required by the calculation of the activity, employment and unemployment rates have been obtained by the Labor Force Enquiry in households (AMIGO).

The employment rate of the population of labor age between 15-64 years counted for 58.8% in 2006. Comparatively to other countries of the same geographic area, the position of Romania is the following: employment rate in the European Union counts for 63.4% for 27 states and 63.8% for 25 states. The first five countries in the frame of the European Union recorded an employment rate of 65.2% while the new members (ten countries) recorded an employment rate of 57%. The non-member countries, other than Romania, recorded an employment rate of 55.7%.

There is an increase recorded for the first 15 countries of the European Union, as comparatively to the previous period, while for the ten countries recently adhered there is an increase of 1% being recorded.

In respect of reaching the Lisbon target in 2010, the dead-line for recovering about 2 percentage points yearly, the level of employment on the overall basis of the 27 states members should count for 70%.

Romania has to recover 11.2% of this gap, which would imply a particular rhythm of development for services and the other activities, an active process of professional re-conversion and, why not, eventually the possibility of using labor force from other European countries as well.

Another aspect to consider consists of the employment rate for the population of age of 55-64 years, out of the total employed population. In Romania, this group of population counted for 42.0%, the explanation for such a level consisting of the fact that many persons of this age get retired on the basis of the provisions of labor legislation; for this category, there is still a long time to go until reaching a retiring level similar to the one in force in the West-European countries.

As for the other countries of the European Union (all 27), the employment rate of the aged persons counts for 42.3% ; for the first 15 countries of the European Union, this rate counts for 44.1%; for 25 member countries, 42.5%. Bulgaria is recording an employment rate of 34.7% for this category of age.

In Romania, the employment rate of the aged persons is close to the employment rate of the 27 member countries of the European Union and we are recording with more that 6% employed population of this category, as comparatively to the new member states of the European Union and Bulgaria. This is a positive aspect which, to the extent the

labor legislation gets materialized and depending on our evolution after the adhesion, means an opportunity to get closer to the forecasted target.

The target level proposed for the year 2010, as set up in Lisbon, asks for 50% of the population of age of 55-64 years to keep on being employed.

At this point, it is necessary to comment a little bit in respect of the average monthly pension in Romania. Here we must point out that, comparatively to 2005, in 2006, the average pensions for the social securities retired persons increased from 267 lei to 311 lei, while for the agriculture retired persons, they increased from 88 to 117 lei.

The total number of the retired persons decreased during 2006, to the level of 5.806 million persons, as comparatively to the 6.067 million persons in 2005.

Meantime, the average monthly pension counted for 298 lei comparatively to 246 lei in 2005.

In terms of structure, the number of retired persons includes 4.611 million persons within the social securities system 1.292 million persons out of the agriculture field.

The pensions increased for both categories, reaching an average level of 311 lei for the retired persons of the social securities system and 117 lei for the retired persons in the agriculture field.

## **12. The average wage in 2006**

In 2006, the average gross wage increased by 18.9%, while the net average wage increased by 16.8%.

From the point of view of the net average wage at the economy level, we find that the top positions keep on being occupied by the employees from the field with a net average wage of 2,306 lei, followed by the employees from the public administration field, with a net average wage of 1,450 lei, extractive industry, with a net average wage of 1,449 lei, post and telecommunications, with a net average wage of 1,358 lei, thermo and electric energy, gas and water, with a net average wage of 1,281 lei, education with a net average wage of 978 lei, transports and storage with a net average wage of 952 lei.

Small income from wage are still recorded by the workers in the field of fishing and fish breeding (498 lei), hotels and restaurants (544 lei), agriculture, hunting and forestry (630 lei).

These are the sensitive fields when forecasting the further development of the social and economic activity from our country, the education and training for the next generations or the maintenance of the population health, all fields of very low income.

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## EFFECTS OF INTEGRATION AND GLOBALISATION ON LABOUR MARKET

■

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**Abstract.** *The relationship economic globalization and labour market functionality is multidimensional and more and more complex. The factors of globalization generate effects that are at once favourable and unfavourable on the national labour market. Lifelong learning and labour force mobility are two essential factors of adjusting national labour market policies in the context of post-accession.*

**Key words:** labour market globalization; employment elasticity; labour force mobility; lifelong learning.

**REL Classification:** 10

■

The social dimension of globalization increases in importance. The opening degree of an economy may determine the fragility of labour market and volatility of balance policies, and efficiency as well if the respective countries have not institutionally and functionally adjusted to the new economic and social conditions. Liberalization and increase of commercial exchanges without adjusting the labour market policies might trigger employment insecurity, increase of workplaces with weak performance, international mobility for higher incomes and social exclusion. A well managed integration might lead to beneficial effects that would compensate/diminish the negative effects such as unemployment or productivity gaps.

**Globalisation does not support an increase of employment elasticity**

With respect to internationalisation of labour market and of globalisation effects on local/national labour market, a series of aspects should be outlined, out of which:

1. Labour market globalisation has known a sinuous evolution already in the 19<sup>th</sup> century, with the emphasis based on regulation/de-regulation. From higher mobility of labour force in the European area of the 19<sup>th</sup> century, gradually a shift was made towards various quantitative, but especially qualitative “restrictions”. Today there are restrictions of labour force mobility that tend to favour skilled and rich ones. From ad-hoc response policies to migration issues, at large, and particularly of labour force, the trend is more and more to bi- and multilateral regulation between states. The contingencies and qualitative selection make more difficult the harmonization process of national/local labour markets. It would be wrong to assume that there is an international labour market (except in a very few select occupations) but it would be equally wrong to assume that labour was fixed in location, as is usually postulated in standard international trade models (Brian Easton, 2001). Consequently, even if on long-term population mobility records a strong ascendant trend, labour market globalisation continues to have strong restrictions generated mainly by the mobility of especially low qualified labour force. If skilled persons are encouraged to migrate, the low-skilled ones encounter the more barriers, the trend being of shifting preponderantly towards the unregistered labour market. The impact of this mobility on the origin or destination labour market is still weakly quantifiable in its integrity, the specific local conditions generating particular effects, more or less pliable on expectations and forecasts. This is one of the major arguments of the atypical behaviour of authorities as an answer to the issue of encouraging/discouraging labour migration.

2. Technological proximity, increased speed of changing technological generations and the impact of ITC on labour and its efficiency is underlined by the fact that, on one hand, there is recorded a long-term trend of diminishing productivity gaps, especially in high-tech fields, and, on the other hand, in less developed countries, “second generation” technological imports make impossible a more dynamic increase of labour productivity in order to catch up with more developed ones.

3. The conditions on national labour markets associated with the social insurance and protection system determine a different labour cost that restricts the trends of “alignment of labour price” to the level of the common labour market, as it occurs much easier on the goods’ and services’ market.

4. The mentality and traditions, labour culture and flexibility to change of labour force very often hamper the dynamics of changes on labour market.

Even if, at first sight, globalisation would be the first and most important factor/incentive of national/local labour markets convergence, the developments of the last decades have shown its failure in creating new and better jobs, or in alleviating poverty and promoting social inclusion (ILO 2005). Globalization has so far not led to the creation of sufficient and sustainable decent work opportunities around the world. Up to now better jobs and income for the world's workers has not been a priority in policy-making (Somavia, 2005, ILO Director-General). The fourth KILM report (Key Indicators of the Labour Market) render evident a more and more weaker relationship between economic growth and employment increase, which means that an economic growth is not associated/translated always with new jobs. If we were to exemplify, we could talk about employment elasticity, indicator that allows analysing the relationship between economic growth measured by GDP and two factors of employment increase, respectively changing (increase/decrease) and productivity. Hence, it was found that, practically, at a percentage growth of GDP in average at world level, total employment is more and more lower, respectively 0.38 percentage points in the period 1995-1999, and 0.30 in the period 1999 – 2003. In Western Europe, where the services’ sector has developed intensely in the last years the share is of 1 to 0.62 (in North America, 1 to 0.57). At the level of Central and East-European countries, the transition to market economy triggered a productivity growth but with a significant diminishment of employment. In the new EU member states (the 10) have recorded a significant increase of competitiveness due to the unit labour cost that was placed at about 70% comparatively to the level recorded in USA. But this competitiveness increase was not translated for the population in created jobs and wages. In the region are recorded high rates of unemployment and increasing inactivity rates as result of discouragement and of ceasing looking for a job.

### **Lifelong learning and labour markets convergence**

The opening of transition economies was associated with the liberalisation of the goods' and services' market, having as effect a diminishment of labour incomes, but the emergence of foreign direct investments has triggered wage increases, the most important ones for skilled personnel. At the same time, FDI determined also a return to school, an increased demand for lifelong learning, for making use of the new technologies and valuation of the opportunities given by ITC.

The multi-dimensional relation between education and lifelong learning and economic growth becomes not only the more complex, but also more intense. The speed and proportions of incorporating technological advancement and ITC applications in activities more and more common generate the permanent need of updating knowledge. From a "luxury" and a privilege for elites, lifelong learning turned into an active component of maintaining employment, and implicitly performance at work. From simple productive activities to the highest skilled ones we permanently need new knowledge, the more and also more updated. From the simple concern for job that would ensure incomes for daily living, the shift was made to concerns related to professional advancement and career development for the vast majority of the active population. In addition, today we must *think globally on long term and act individually on short term*. This presupposes knowledge and broad and interdependent vision of issues related to human development. From a relatively passive factor of development, labour potential and quality became active instruments for stimulating competitiveness increase and diminishing the productivity and income gaps. Education, and associated with it, lifelong learning transform themselves into restrictions and results of economic growth, but the effects of lifelong learning are found again into higher output and incomes in the propagated system on medium- and long-term. Endogenous growth models that take into account the long-term rate of economic growth might more obviously reveal the impact of education by the labour effects on economic growth and human development. In addition, the habit of lifelong learning triggers and is generated by the need to cope and have performance today and tomorrow in a permanently changing environment. As result, labour market mechanisms aim less and less at regulation and are oriented towards the more on prevention, and anticipation policies with respect to developments on labour market. The unemployment recorded, for instance, no longer defines sufficiently



enough the labour market imbalance, the labour force mobility and under-use of labour potential by increasing the share of involuntary part-time labour, characterising just the same actual attributes of labour market.

The convergence of national labour market and its operational consonance with the enlarged labour market (the EU area) is adjusted by the specific of the labour model and of the local/regional/national social model. But this thing does not hinder the meeting, and functional harmonisation trends on a common basis, that is the specific *acquis communautaire*.

### **Economic globalisation and labour market functionality**

The main factors of globalisation – international trade, technological change (especially the ITC dissemination), capital flows (FDI) and customs policy – directly influence labour market, due to effects such as unemployment adjustment, external mobility of labour force, the effect of goods' and services' prices on the incomes distribution and on wages inequity, the change of labour conditions and of industrial relations. A series of performed studies (Bhorat, Lundall, 2004) have identified the following effects:

- a) the relative wage of auxiliary workers is associated with the relative growth of employment in the specific sector due to the more rapid growth of tariff prices for the services delivered by them;
- b) technological inflow and FDI represent the most important sources of increased wage differentials; similarly is manifested (but indirectly) the effect of trade (for products with incorporated technological progress of higher level);
- c) The effect of globalisation on the wages' level is mixed. On one hand, the trend of maintaining low wages determined by trade liberalisation, and, on the other hand, the one of increasing labour earnings as result of FDI flows;
- d) unemployment increase among youth with professional training but without labour experience, which in a first stage after employment generates a relatively lower productivity comparatively to the wages expected by them;
- e) Increasing skilled and young labour force mobility by considerable exit follows, with high mobility towards more developed countries.

All in all, the costs with investments (with initial education) in unvalued/unused human resources on the national market, and those with the regulation policies for imbalances on labour market are relative and cumulated on medium and long-term higher than the remittances and other economic and social-human benefits (labour conditions and living standard). The negative effects are largely overshadowed by the positive effects (Bhorat, Lundall, 2004).

But the main effect of globalisation on labour market is represented by the increase of labour force mobility. Globalisation appears as redistributing workplaces. Low paid workplaces no longer are the attribute only for developing countries but are associated with those local areas/markets in which capital and labour were not reallocated and updated in accordance with the dynamics of the changes from the production environment and services. High wage workplaces are reallocated to those areas in which there is/is developing a strong tertiary sector and/or where the dynamics of incorporated technologies is associated with high rates of attracting/shaping gross capital formation and with the creation of new and performance jobs. For Romania, a country facing more and more severe imbalances and chronic personnel deficits (on occupations and top-professions), the relief valve of these dysfunctions are the policies of attracting and stabilising young and performance labour force by active levers such as the perspective of professional fulfilment and/or financial comfort. Unfortunately, still few is done in this respect and the expected effects on medium- and long-term are already giving reasons for concern, and more aggravated by the more and more accelerated process of demographic ageing.

### **Policy measures for increasing employment**

Employment remains the balancing and rendering efficient factor of labour market functioning and of furthering economic growth. Labour incomes are associated as incentive to labour performance and increasing demand of goods and services, with effect on alleviating poverty, and active promotion of social inclusion.

In the Report of the World Commission regarding the social dimension of globalisation (ILO, 2004) investments, growth and employment were identified as key challenge for the multilateral system. Policy measures must be flexible sufficiently enough, complementary, and transparent. The active measures on labour market for ensuring the compatibility of labour force supply attributes with the demand enter into

resonance and generate cumulated effects with social policies – of active social protection for the potentially active population, especially of vulnerable groups (youth, women, and lately elderly who remain active). The capital and CVT investment without finality from the perspective of employment increases vulnerability and fragility of the local labour market. Unfortunately, in the field of human resources the adverse effects of promoted policies are not only lasting but also costly at social and human level, often leading to discouragement and social exclusion.

Sustaining employment as source of economic growth and of human development is based on the following factors: vocational training, gaining new competencies and entrepreneurial spirit towards on working capacity. At individual level these factors support employment and/or increase the employability.

At company level, competencies and skills of employed labour force define the capacity of the company to create and use emerged business opportunities. Promoting the culture of performance work and continuous training at job are essential to the company's capacity of absorbing technologies/incorporating technical progress, of innovating and developing (Foss, 2003).

The challenges for Romania in this respect are several and differ in nature. From the ones related to mentality – on labour and continuous training, of the employee but especially of the employer – to the ones referring to the manner of approaching policies and rigor in implementation. Priorities are a concern for beneficiaries, but also for the promoters/facilitators of policy measures. The major intervention areas on labour market consider:

- a new design of training policies for adults to create employability opportunities;
- incentives for gaining associative competencies for using new technologies;
- gaining competencies for supporting alleviation/reducing the risk of poverty;
- promoting entrepreneurial culture among youth and supporting them for stability on labour market;
- integrated information system to allow for transparency of market components, resources management, and especially promoted policies;
- Instituting a follow-up system for facilitating monitoring, evaluation, and possibly adjustment of promoted measures.

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**ADVANTAGES FOR THE REPUBLIC OF MOLDOVA TO JOIN  
EUROPEAN UNION, AND THE DISADVANTAGES OF ITS  
REMAINING WITHIN CIS**

■

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**Abstract.** *In these material are presented the advantages and the potential consequences of addition of Republic of Moldova to EU. And in the same time are described some negative results of near future of Republic of Moldova into Independent States Community.*

**Key words:** integration; advantages; disadvantages; European Union.

**REL Classification:** 3D, 20E

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*Since the adoption of the Declarations of Sovereignty (23<sup>rd</sup> of June 1990) and Independence (27<sup>th</sup> of August 1991) until 2005, that is, for a decade and a half, there have been a lot of discussions, all useless in essence, about the strategic orientation of the Republic of Moldova (RM). In this period, other Newly Independent States (NIS) – the Baltic states (Estonia, Latvia and Lithuania), more advanced both economically and politically – used their time more efficiently and univocally oriented towards the actual EU<sup>(1)</sup>. This allowed them to attain the historical objective (the ideal) by the 1<sup>st</sup> of May 2004, when these countries, together with other ex-Socialist countries, joined the world's main economic pole.*

The decision of principle taken by the Parliament in 2005 about strategic orientation of RM to EU, although belated, is the only correct and extremely beneficial one, especially because it was voted unanimously and thus will never be subject of any revision, neither from within, nor from outside, nor will it be subject to biased comments.

However, RM is currently a part of the so called Commonwealth of Independent States (CIS), which, though not crystallized yet, is already decomposing<sup>(2)</sup>. This process, though will take some time, might (or will) cause multiple problems. However, in our mind, they will be of a temporary nature.

Below we will present some arguments considered especially attractive for RM to choose the direction of European integration.

1. Accession [of RM] to EU actually means being within a group of economically developed countries, with a deep culture and a high civilization, verified by centuries.

CIS orientation actually means targeting a group of countries, which have, at best, an average level of economic development, or even poorly developed. During their history, the countries that make up the CIS never were included in the list of developed countries.

Russia, a country with the greatest economic potential from all CIS countries, is placed 11<sup>th</sup> to 15<sup>th</sup> in the world according to GDP in absolute figures, while its GDP per capita is much below the respective indicator of Portugal (last place in EU-15) and is placed 60<sup>th</sup> to 70<sup>th</sup> in the world. According to calculations of Russian economists, Russian Federation will attain the level of Portugal by no earlier than 2030. For example, Russian GDP in 2003 amounted for 433.5 bln. USD, while the GDP of the Netherlands (a country with area comparable to RM) for the same year was 511.6 billion USD (both figures are in current prices). Correspondingly, foreign trade of these countries (in 2004) was 257.2 and 601.1 bln. USD respectively, i.e. in the Netherlands this indicator is more than two times higher than in Russia (Belli, Ioan-Franc, 2004, p. 533-555).

In EU, the average nominal GDP per capita is about 40 to 50 times larger than in CIS countries. Comparative data on GDP per capita in EU (27) and in CIS (=12) are presented in Table 1. The conclusions are obvious. According to UNO data, most EU states are topping the Human Development Index (HDI) rankings<sup>(3)</sup>, while none of the CIS ever rose higher than 55<sup>th</sup> place in this ranking.

2. Countries members of the narrow EU (the 15 members before 2004) have no or insignificant external public debt, which means they are donors/creditor/financing states of both Europe and the world (and of CIS countries). These countries usually have surpluses in their balances of trade and payments.

**GDP per capita in EU and in CIS countries (in the order of  
decreasing GDP per capita), USD**

Table 1

Countries	1999		2004 at PPP	
	at PPP (at purchasing power parity)	at current exchange rate		
A. UE Countries				
1. Luxembourg	(1)	42 769	44 740	61 220
2. Ireland	(8)	28 918	24 896	33 170
3. Austria	(11)	25 089	25 726	31 790
4. Denmark	(9)	25 869	32 722	31 550
5. Great Britain	(21)	22 093	24 231	31 460
6. Belgium	(10)	25 433	24 291	31 360
7. Holland	(14)	24 215	24 909	31 220
8. Sweden	(19)	22 636	26 947	29 770
9. Finland	(16)	23 096	25 099	29 560
10. France	(18)	22 897	24 434	29 320
11. Germany	(15)	23 742	25 724	27 950
12. Italy	(20)	22 172	20 313	27 860
13. Spain	(29)	18 079	15 121	25 070
14. Cyprus	(25)	19 006	11 875	22 330
15. Greece	(36)	15 414	11 870	22 000
16. Slovenia	(34)	15 977	10 079	20 730
17. Portugal	(33)	16 064	11 384	19 250
18. Malta	(38)	15 189	9 207	18 720
19. Czech	(42)	13 018	5 167	18 400
20. Hungary	(45)	11 430	4 811	15 620
21. Slovakia	(47)	10 591	3 653	14 370
22. Estonia	(57)	8 355	3 628	13 190
23. Poland	(56)	8 450	4 014	12 640
24. Lithuania	(69)	6 656	2 875	12 610
25. Latvia	(71)	6 264	2 575	11 850
26. Romania	(73)	6 041	1 515	8 190
27. Bulgaria	(85)	5 071	1 511	7 870

Countries	1999		2004 at PPP
	at PPP (at purchasing power parity)	at current exchange rate	
B. CIS COUNTRIES			
1. Russia	(63) 7 473	2 746	(54) 9 620
2. Kazakhstan	(88) 4 951	1 061	(69) 6 980
3. Turkmenistan	(111) 3 347	670	(71) 6 910
4. Belarus	(66) 6 876	2 673	(72) 6 900
5. Ukraine	(108) 3 458	774	(80) 6 250
6. Armenia	(130) 2 215	484	(97) 4 270
7. Azerbaijan	(119) 2 850	502	(103) 3 830
8. Georgia	(122) 2 431	502	(111) 2 930
9. Moldova, Rep. of ~	(132) 2 037	271	(128) 1 930
10. Uzbekistan	(128) 2 251	725	(131) 1 860
11. Kyrgyzstan	(121) 2 573	257	(134) 1 840
12. Tajikistan			(146) 1 150

**Note:** Figures in parentheses show the place of the country in world ranking for that year.

**Sources:** Matei et. al., 2005, Matei et. al., 2006. More recent comparative data are missing.

During their history, all CIS countries traditionally, chronically were, are and will probably long be debtor-states (with significant external, including public debt). For example, Russian Federation has external public debts, being one of the world's largest debtors. Most of these countries have traditionally had or still have deficits in their balances of trade and payments. In the last years, some countries – Azerbaijan, Kazakhstan, Turkmenistan and Russia – improved their situation due to growing prices for natural resources, but from the point of view of technology and science-intensive production they remained and may stay forever in the queue-end.

3. EU is, first of all, an economic and monetary formation with a high degree of integration, with a common currency (EMU currently includes 13 countries), which is (since 2002) also a reserve currency actually used by most states of the world etc. In several years "Euro" currency managed to almost equal US dollar, which dominated international financial relations for almost 6 decades. European



community actually comprises the states which, if taken together, represents the part of Europe (and of the world) with the richest traditions in most social and economic spheres.

The major objective of CIS is of political and military character, where, as shown by the experience of a decade and a half, the interests of the member states are represented non-proportionately, not to say non-equitably. Within this structure, every member state uses its own currency, which is a “soft” and internally circulating one (some countries do not even have a national currency yet, a necessary stage in attaining its sovereignty).

4. Accession of different states to EU is strictly voluntary and is every time initiated by the candidate country itself. More that that, every of them has to correspond to certain criteria (preconditions) of convergence (of accession): economic, financial, legal, political etc. In case of non-compliance to these criteria, every country elaborates programs of gradual adjustment of situation in different domains. Acceptance is done only after the candidate country complies to common requirements of the Union. This procedure and provisions oblige the authorities of the candidate states to undertake real steps in improving the internal situation in a relatively constrained period of time.

In reality, adherence of ex-Soviet republics to CIS, initiated (in 1991-92) by several interested states, was indirectly imposed/recommended (for example, by signing the letters of acknowledging independence). Rejecting the “invitation”, as shown by the experience of one and a half decade, bears negative consequences for the “invitee”, thus being practically impossible. The “candidates” do not have to correspond to any economic or other criteria, the acceptance (almost unconditional) of adherence being the only condition<sup>(5)</sup>.

5. UE (previously EC, EEC) represents a structure, which actually “wrote” its rich history of 5 decades, when this formation evolved from 6 (March 25, 1957) to 27 countries (January 1, 2007), comprising most of the Western and Central Europe. In 2004, it accepted 8 countries, which had been staying under USSR political and military ward for 4 decades, being a part of former totalitarian Soviet bloc.

CIS did not actually establish as a “community” in a strict sense. For this reason more and more NIS question its efficiency and frequently refuse to take part in the annual meetings. Some states did not actually sign some foundation documents or abandoned, partially or entirely, this formation (Tajikistan, Georgia, the Ukraine etc.)<sup>(6)</sup>, while Moldova, having a status of a neutral country, does not take part in military

structures. The existence and efficiency of CIS is being questioned by the participants, including the founder states. Other structures of these countries were created in parallel – for example, GU(U)AM by Georgia, the Ukraine, Uzbekistan (in 2005 this country cancelled its membership), Azerbaijan, Moldova. There are pronounced economic tensions within CIS – for example, the war of oil and natural gas prices (2005-2007) against the Ukraine and Byelorussia, the war of wine and mineral water, oriented against RM and Georgia, respectively, etc. Collaboration of the former Soviet states within various international and regional structures (IMF, IBRD, EBRD, WTO, CEFTA etc.) reduce the functionality of CIS to zero.

6. EU countries promote democratic principles in the sphere of political management. For example, the capital of EU is in Brussels, the capital of one of the smallest Union member states (with an area smaller than the area of RM) and not in the country with the greatest demographic, economic, commercial, financial, technological, scientific etc. potential (Germany).

Many EU decisions are adopted by consensus (unanimity) and with no pressure from other states. Referendums are also applied as a form of major decision-making (for ex., on extending the EU, on adoption of the EU Constitution etc.).

CIS is actually administered by a single country, while the role of smaller states in decision-making is insignificant or symbolic. As a consequence, CIS management is monopolized. Probably, this is one of the reasons why in the recent years the top leaders of the member states are rarely present on the meetings, which are generally unproductive. Most documents signed within this structure are not being fulfilled. For example, territorial integrity of RM and other countries (Georgia etc.) is being violated. For almost one and a half decade, RM authorities do not possess complete economic, financial, commercial etc. information about the entire constitutional territory of the country<sup>(7)</sup>.

7. There is a high level of mutual economic relations in the EU – up to  $\frac{3}{4}$  or  $\frac{4}{5}$  of member states' foreign trade goes to the "rest" of EU. There is a common market for labor force, capital, goods and services. Thus, EU space means free circulation of citizens, capitals, goods etc.

The degree of CIS integration is insignificant. There is actually a process of economic disintegration. Countries apply restrictions to their mutual trade – establishing and frequently revising import quotas (included by local state bodies) for various products, yearly modifying sanitary certificates for importing certain products (for example, by the

Russian Federation) etc., as well as political conditioning of foreign trade. There are more and more communication problems in the CIS, circulation of citizens being restricted more and more. The restrictions also apply to money flows. For instance, the Russian Federation is examining a draft law on prohibiting money transfers from Russia to other NIS countries by their citizens, temporarily working in this country.

8. Generally, there is a high degree of political, inter-personal etc. relationships among EU countries, and there are no territorial disputes. In other words, military conflicts among them are impossible. Thus, EU is a zone of stability, not just economic, but also political, inter-ethnic, inter-confessional etc.

From the foundation of CIS there were and still are a series of conflicts, including military ones, which led to various confrontations (Armenia-Azerbaijan, Moldova-Russia, Russia-Ukraine, Russia-Georgia etc.) still unsolved. Russian Federation authorities often threaten territorial integrity of the Ukraine, arguing that the cession of Crimea peninsula (in 1954) was illegal.

In these conditions, it is difficult to consider CIS as a “community” in the real sense of this word. In this space, as stated by many specialists, there is no durable stability and predictability – economic, political, commercial, financial, monetary, etc.

9. In the EU space, first of all in EU-15, the share of shadow economy is relatively insignificant. Even the countries with the highest indicator (Greece, Italy, Portugal) have a controllable and predictable situation, with a downward tendency of the respective indicator.

According to the data of the World Bank and the European Center for Transparency, in most CIS countries, and first of all in Russia, a country with the region’s highest potential, there is a significant share of shadow (unrecorded, criminal) economy, high corruption etc., which makes this region fragile, repelling and unpredictable, even for a short term, thus amplifying instability and uncertainty.

10. The legislation of the community states is unified or harmonized. This implies its stability in time and similar treatment in space (within the member states), with all respective multiple favorable consequences. There are secular normative-legislative traditions in this space. Besides this, the legal provisions have a high degree of realization, confirmed by an adequate publicity.

CIS countries, except Russia, have no sovereign experience (beyond about 15 years). Within CIS, there is a significant variety of legal norms which differ both among them and from the EU norms. Economic

and other legislation within CIS is unstable, easily modifiable and has a low degree of realization. Legislative bodies are much dependent on political structures and have no consistent traditions in this domain. Finally, NIS borrow, with different rate of success, legal provisions of the EU countries.

11. EU is an open community with an increasingly efficient control by the civil society.

NIS (ex-Soviet) are still quite close and have no efficient civil society, measured as a possibility of non-government structures to control the authorities.

12. In EU, there is a significant common budget of over 120.0 billion Euros per year, used for various community purposes, inclusively for removing or gradually diminishing the differences in social and economic development, etc. For example, the 2007-2013 community budget contains funds designated for Poland – 67 billion Euros, for Romania – about 30 billion euros etc. The application of the community funds excludes any possible irresolvable divergences between different economic territorial zones of the member states. This can be confirmed by corresponding regional statistics. Obviously, the degree of utilization of these funds depends on the real absorption capacity of beneficiary states.

The “community” funds designated for diminishing of under-development do not exist in CIS. All CIS countries can be considered developing, and many regions – under-developed.

13. There is a significant, continually increasing technological and scientific potential, inclusively due to a number of researchers emigrated from the ex-Socialist bloc. The share of funds allocated for research and development is increasing up to 3-4% of GDP (Finland, Sweden, etc.).

Technologic and scientific potentials of CIS countries, inclusively due to economic downturn during the transition period, are still in a relatively continuous decrease. To our mind, any significant reduction of this deviation is impossible (in average or even long term).

14. EU, with about 500 million citizens living in it (although there are 22 official languages), English and French are used as (intra-community) communication languages, both having an increasing international circulation and both actively penetrating the ex-Communist space. These languages are official or state languages in over 100 states of the world, and the number of people speaking these languages outside the anglophone and francophone spaces is continually increasing (for example, the number of people who study English is over 300 million only in China).

In CIS, the only circulating language is Russian, which has a constrained area of utilisation. If before 1991, the year when ex-USSR was broken down, the Russian language was largely used in 15 ex-Soviet states, with a population of 280 million inhabitants, then after a decade and a half this area diminished roughly by two times, with a clear tendency of further decrease, inclusively in the Russian Federation itself (where the number of russophone population is diminishing and the relative share of other nationals is rising).

15. EU represents the highest degree of international economic and territorial integration, based on a n internal multilateral integrity.

CIS can not represent a form of inter-state integration, at least because many states, currently its members, are actually not entirely integral in their territory. This is why it would be necessary that all “community” states really assure territorial integrity of their partners, which did not happen so far. A decade and a half should have been sufficient for this to happen, but it did not happen.

Thus, we can state that there is a high degree of real integrity within the EU, which insures a decent living standard for the Union’s populations, a standard by “many decades” more advanced than that of the ex-Socialist bloc countries. Obviously, every country, every nation has to build its present and future according to its own model, but in an efficient, predictable and durable collaboration with the best partners. Joining EU implies some costs, including partial loss of sovereignty, but finally, as the retrospect shows, this is recoverable and does not represent waste of funds and of time.

### **Estimating the consequences of joining the EU**

A natural adhesion of RM to EU would allow for solution of many major problems, which could not have been solved with such an extremely positive support.

1. In our view, the main problem that can be solved by common efforts of “the 27” is territorial re-integration of the RM. It was divided after the undeclared Russo-Moldovan war of March 2, 1992, the day RM joined UNO (its international acceptance). After this unequal, conquering war initiated by the 14<sup>th</sup> Russian Army, this one, as stated by the first democratically elected Parliament, occupied a part of the Eastern region of Moldova (actually the former Dubasari district) and still illegally stays there, without the officials’ consent and without due payment (specifically stipulated by the 1992-1993 RM Parliament Decisions).

Because there was no and there is no justification of this occupation act (known in detail by all EU states), the Russian Federation, as per Istanbul decision of the International Community of 1999, had to unconditionally and immediately withdraw its military troops from RM.

The presence of temporary occupation forces divides the economy and encourages an excessive development of criminal economy in this part of RM, which is effectively out of official control. As reported to RM official structures, the economy controlled by the 14th Army was and is completely unrecorded and shadowy.

2. Territorial re-integration would objectively lead to insuring economic, political, legislative, demographic, institutional, administrative, decisional, informational, financial, fiscal, customs, banking, scientific, etc. integrity, with all positive consequences following thereof.

3. An important achievement of RM in European integration would be sensible and rapid decrease of unrecorded/criminal economy, which becomes more and more dangerous for the sovereignty: according to estimations, inclusively by IMF and IBRD, the unrecorded economy exceeds the volume of the recorded one.

One of the causes of rapid decline in official economy (comprised by NBS records) between 1990-1999 was namely the rapid (deliberate or non-deliberate) growth of the uncontrollable economy.

The significant and rapid decline in the unrecorded economy (during several years after joining EU) would serve, in our view, as the *main source of ascending development of RM economy*. Territorial integration and the decrease the now-unrecorded sector would allow us to ensure a double-digit annual growth rate in as much as 5 years and to increase by several (3 to 5 according to estimations) times the real per capita income. This would allow RM to leave the Europe's last place, held by many years.

4. Joining the UE would improve the international and European status of RM, which is currently disgraced.

5. RM is currently in a catastrophic demographic state. According to many data sources, the number of Moldovans temporarily working abroad, first of all in EU, is 1 million people of 4.3 million inhabitants. Revitalizing and legalizing the economy, sensibly increasing monetary income of the population, increasing the internal final consumption would contribute to stopping the mass emigration, as well as to gradual returning of some current Moldavian emigrants back to the motherland.

6. Accession of RM to EU would contribute to *legalizing a significant number of Moldavian citizens currently staying in this space*,

most penetrated there in an illegal manner. Only people with Romanian passports stay there legally (about 100.0 thousand Moldavian citizens regained Romanian citizenship, other 900.0 thousand have applied for it by February 2007). Such a legalization would allow their mobility within EU, including a possible unrestricted return of a part of them back to RM, especially if we take into account that currently at least one half of all Moldavian emigrants are illegally staying in various countries.

7. Obtaining European citizenship would lead to an indirect destruction of illegal structures (in RM and in other states) currently involved in counterfeiting documents for travelling abroad, first of all to EU, by making them useless (according to some estimates, the costs paid by Moldavian citizens for acquiring fake documents in order to travel abroad make up some million euros per year). This would have favorable legal, financial, social, etc. consequences.

8. Joining the EU would mean re-orienting external commercial relations towards this space, which would mean stability and predictability of economy in general, as well as of economic agents in particular. The factor of uncertainty in the foreign trade sector, currently persistent in RM economy, would gradually diminish.

9. EU integration would contribute to national revival of Basarabian Romanians, to Europe-likeness of Bessarabia, to consolidation of the common Romanian space: economically, culturally, linguistically, by transports, infrastructurally, etc., as well as to intensification of relations in the entire Romanian space as a whole.

10. Taking into account that during (temporary) ex-Soviet occupation, especially in 1940, as well as in the first after-war years, several thousand inhabitants of Basarabia and North Bucovina were deported (to Siberia, to Kazakhstan, etc.), RM adhesion to EU would contribute to repatriation of some of them.

11. Joining the EU would contribute to improving the internal and external economic and political management of RM.

Although the RM Parliament favorably appreciated joining EU, there are still opponents (especially other-language speakers) of the natural process of European integration. They “propose” the RM first attain the development level of Switzerland or Norway, and after that join the EU. Not joining this argument, we would mention that such a “proposal” means we never integrate, because neither with EU, nor without it the Republic of Moldova will be able to attain the level of these two countries, which are currently not members of the Union.

However, economic development would be more sustained and efficient within the EU.

The experience of just several years, since Estonia, Latvia and Lithuania are in the EU, show that, although these countries have been incorporated in ex-USSR for as much time as the Republic of Moldova, significant performance can be attained in a short time within EU. For example, although these countries are comparable with the Republic of Moldova by the area, population, natural resources, etc., they currently exceed the Russian Federation, which the world's richest country in natural resources, according to GDP per capita by 1.7 – 2.0 times (in 2006).

Being part of a winner team, where one objectively wants to belong, means being more efficient for the one's benefit.

Before RM joins EU, the latter approached RM on January 1, 2007 by accepting Romania, becoming an important and desired neighbor.

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**Notes:**

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<sup>(1)</sup> According to West-European experts' forecasts made at the end of 1980s, Moldova and Georgia are the quickest states, after the Baltic states, to dispose of ex-USSR and then Russia's policy.

<sup>(2)</sup> This was emphasized by Russian minister of external affairs (Evghenii Lavrov) in his speech to Russian State Duma (March 2007).

<sup>(3)</sup> HDI is a complex indicator, which, besides GDP per capita, includes life expectancy, level of education etc.

<sup>(5)</sup> The first Parliament of RM, in its Decision taken about 14 years ago (on August 4, 1993), rejected the adherence to CIS. The following events showed that the decision was correct. The Parliament Decision of 2005 actually cancelled the decision of the second Parliament about RM joining the CIS.

<sup>(6)</sup> In March 2007, Georgian Parliament unanimously voted for their country's adherence to NATO.

<sup>(7)</sup> It must be mentioned that, due to inefficiency and inequitable relations among the member states, all structures initiated by Russia (previously ex-USSR) – Warsaw (military) Treaty, Council for Mutual Economic Aid (CMEA), the so called Socialist bloc, the ex-USSR itself and the affiliated structures – did not survive for long time.



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## SPECIFIC FEATURES CONCERNING THE MARKET RISK MANAGEMENT



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**Abstract.** *The market risk management is very important in the context of the volatility of the exchange rates, interest rates or financial assets prices.*

*In order to be aware of these developments there are a number of internal statistical models, of Value-at-Risk kind, which are used. These models are measuring the maximum loss recorded by a certain portfolio and that is why models such as the correlation method, the historical stimulation method, the Monte Carlo method are used in this respect.*

*In the present text I have approached significant aspects as regards the management of the interest risk, by underlying to following aspects: structural risk, structural exposure of the bank, balance sheet structure, structure of the banking profit and of the interest rates depending on maturities, transaction risk, uncertainty of the interest margin etc.*

*The methods and techniques being utilized as for the interest risk management are also extensively presented within this material, as they are evidencing essential elements occurring in practice.*

*The last part of the text is pointing out the significant aspects regarding the utilization of the swap contracts in the management of the interest rate risk.*

*The approach of this last topic is accompanied by empirical examples meant to let the understanding of the issues in discussion become more accessible.*

**Key words:** market risk; value-at/risk; interest risk; swap contract; portfolio.

**REL Classification:** 7J, 11B, 11F



### 1. Theoretical arguments concerning the market risk

The last decades have been marked by an un-precedent increase of the volatility of the exchange rates, interest rates and financial assets prices, along with the proliferation of the derivative financial instruments used for the management of risks implied by the adverse development of these variables. Under the circumstances, there is a new type of risk which occurred, known as *market risk*.

The market risk consists of unfavorable situations arising as a result of the alteration of the main parameters of the market where the financial institutions operate, respectively the interest rate, the exchange rate and the value of the financial assets of a portfolio.

The financial institutions of prestige from the developed countries are watching and evaluating the market risk on the basis of the quantitative models. In terms of classical approach, the capital requirements as to the financial instruments are the result of adding up the capital requirements for every financial instrument of the portfolio structure. An alternative approach is given by the internal models of statistical nature, of the value-at-risk kind (VaR), which allow the different components of the risk being quantified as a sole quantitative indicator showing, meantime, the possible loss over a certain time horizon.

The concept of *value at risk* is typical for the 1980's years, a period governed by an un-precedent volatility of the financial market parameters, when it was used by the large financial companies in order to quantify the risk of the portfolios they held. Its importance has been confirmed also by the 1986 amendment to the first Basel Agreement (Basel I 1998), which recommended the utilization of VaR for setting up the minimum limit of capital required for the banks in order to cover the market risk.

The attractiveness of the VaR utilization as an instrument for evaluating the market risk consists of:

- offering to the bank /investor the maximum potential loss;
- a calculation methodology relatively easy to handle;
- expressing the market risk of a portfolio by a single figure.

Irrespectively the method being used (correlation method, the historical stimulation method, the Monte Carlo method), the market risk of a portfolio is expressed by one digit figure.

The VaR measures the maximum loss a portfolio may bear, with a certain probability, as a result of the evolution of the market parameters within a certain period of time, being thus a global instrument for measuring the market risk, capable to take into account the interactions between the relevant risks.

*The correlation method* is using, for estimating the future losses of a portfolio, statistical data regarding the dimensions of the market parameters volatility as well as the correlations between their variations. It is assumed that the statistical distribution of the assets yields is a normal one, which helps an easier use of the method. When considering only one parameter, it is very easy to calculate the market parameter volatility (interest rate, exchange rate) implying an adverse influence on the outcome. The issue gets more complicated in the case of a portfolio, when the outcome is induced by the correlations.

*The historical method* rejects the normal distribution of the assets yields, the VaR estimation being calculated on the basis of the lowest yields out of the historical records.

*The historical simulation method* is using statistics and risk factors for estimating the VaR. For instance, an asset whose value is denominated in free currency is simultaneously subject of both exchange rate and interest rate risks. One of the advantages of this method arises out of the fact that the model uses the empirical distribution of the yields, as set up by the analysis of the previous data. Methodological wise, this model is relatively simple as it does not require a variance-covariance matrix to be set up. The model limit is given by the representation level of the outcome being obtained by processing data which are specific to past events.

*The Monte Carlo method* or the stochastic simulation method is used for evaluating the portfolio which is subject of the simultaneous effects of several factors action. Despite the fact that this method takes the advantage of being a flexible, it is seldom utilized because the costs and time requirements it involves. The method implies a mathematical modeling for forecasting the future shocks and uses the historical changes of the risk factors in order to generate a complex mathematical model which includes the factors being taken into account usually as a multiple regression form. The out coming model is used for calculating the possible future value of a risk factor, by simulating its behavior. By repeating the simulation, on the basis of a large number of iterations, a distribution of the future values is to be identified. Each value thus obtained gets a probability of occurrence, allowing the portfolio values to

be put on a hierarchical system depending on the selected criterion (up-warding or down-warding).

Out of the comparative study of the methods which can be used, obviously the Monte Carlo simulation has a series of advantages: accuracy for all the instruments; providing a whole distribution of potential values of portfolios (not only a specific repartition function); allows various distributional assumptions (normal, T distribution) to be used and, thus, holds a potential to address to abundant series (known as leptokurtosis); does not require historical data for large periods of time; does not imply linearity, distribution, correlation and volatility, all these prevailing against few disadvantages only: intensive estimation on a long run (implying that the portfolio should be re-evaluated for each scenario); it quantifies the risk for an abundant series only in case that the market scenarios are generated out of adequate distributions; it applies in connection with the types of instruments (linear or non-linear).

The models of VaR type are recommended by the Basel Committee for the purpose of quantifying the market risk. Taking into account the limits of this model, i.e., the fact that on a turbulent market the calculated risk value does not provide a correct representation of the losses and the market liquidity is not included in the VaR calculation, there are several alternatives to consider against the value at risk, among which the tests at stress and the extreme value theory are to be considered.

The Basel Committee recommendation involves also the possibility for the banks to regularly use a *stress testing* program in order to identify the events or the influences which may have a negative impact on the bank capital position.

The complexity of the test denotes the complexity of a bank exposure to the market risk and, as this is continuously moving, the scenarios and the test results must be periodically revised by the top level management of the bank.

The models of evaluating the market risks, as recommended by Basel II, have been implemented to the market risk management run by the credit institutions from Romania. At this level, the foreign banks subsidiaries are taking a considerable advantage, to the extent that they have adopted internal models for evaluating and managing the market risks, as utilized by the mother-banks located within the EU, which are already validated by the respective regulating authorities and which, implicitly, are going to be accepted by the RNB as well. The still outstanding problem to consider is concerning the extent to which the

implied costs are justifying the implementation of these internal models, view the number relatively small of the financial instruments and the transactions volumes. For instance, Société Générale benefits of complex systems for managing the market risk, at the level of both *front-office* and specialized departments for *back-office* and market risk control, the exposures being thus watched in terms of real time. This bank is using its own value-at-risk model for the exchange position.

The studies on the quantitative impact, drawn up by the Basel Committee, indicate that by using the standardized model, the capital needs of the banks would increase to a small extent only, contrary to the internal models which would induce a considerable diminishing of these requirements of capital. Although the second option is more attractive, the banks from the emerging countries might take advantage of it only to the extent that complex data bases, covering at least five years, are available.

Apart this, the banks are using also the internal models for evaluating the market risk. The banks options as to the internal models are grounded on qualitative standards issued by the Basel Committee. These standards comprise a confidence interval of 99%, a holding period of 10 days of transactions, a period of historical surveillance of minimum one year. VaR is calculated daily while the capital requirements, as implied by the market risk, are fulfilled daily as well.

Irrespectively the models being used for the market risk quantification, they provide the deciders with necessary information concerning the bank exposure to risk, allow the setting up of certain limits of exposures which are considered as obtainable for the bank risk profile and, but not the last, allow the setting up of the capital requirements for the market risk.

## 2. Considerations in respect of the interest risk management

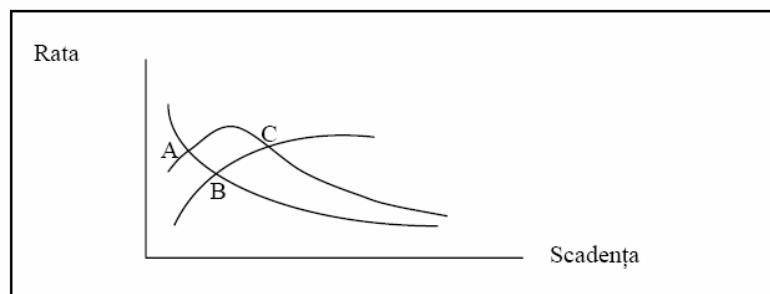
The development of the crediting operations bearing a variable interest, the interest rate fluctuations, which became more aggressive mainly after the years '80, the constant instability of the interest rates level count as a number of reasons leading to the reconsideration of the interest rate risk. This risk is in fact a typical example of risk from two points of view as, on the one side, it defines the exposure to a loss or a gain affecting the net income out of interests and, on the other side, it defines the updated allocation of the financial assets hold by the credit institution. Based on these arguments, the interest rate risk may be considered as being a *structural* risk, when put in relationship with the net

income out of interest and a *transaction risk*, when put in relationship with the financial instruments.

*The structural risk or the structural exposure of the bank* is more aggressive in case of the interest rates decrease. The interest rates decrease is affecting the banks in a different manner, depending on the structure of the balance sheet and the structure of the banking net profit.

*The structure of the balance sheet* is influencing the bank exposure to a risk induced by the interest rate decrease because of three reasons, at least:

- the complexity and diversification on the bank activity since a bank running such activities is more exposed to the risk, if comparing it with a specialized bank;
  - the rates structure (fix, variable) which induced the management of gaps or deadlocks of the rate;
  - the structure of the banking assets with different deadlines/maturities and which are conditioning the incomes to be cashed in the future.
- Thus, each bank should take into account the possible evolutions of the interest rates, as shown by the graphic below:



**Figure 1.** *The interest rate structure by maturities*

Starting from these possible evolutions of the interest rates, the bank may resort to the rate arbitrage, aiming to get profit out of the rate gapes. The above diagram indicates that in the points A, B, C, which belong to *neutral rates* or *dead-point rates*, both the long run and the short run operations are equivalent. The bank ability as to maximize the profit consists exactly of the overcoming this threshold (in respect of the profit equalizing), by resorting to simulation models for the effect of the interest changes.



*The banking profit structure* implies different exposures of the banks depending on the main sources of income, to the extent that, if the incomes out of interest hold a smaller weight as comparatively to the average of the banking system, the exposure of the bank as to the interest rates decrease will be lower.

*The rates structure depending on the maturity* (yield curve) is establishing the rate risk to the extent the rate changes have a negative influence the economic value of the bank or the yield curve is negatively affecting the bank incomes. That's why the bank should be provided with models in respect to the simulation of the market effect of the rates changes.

*The transaction risk or the transactional exposure* occurs when the bank is involving itself in operations with new financial instruments (financial derivative products).

The interest rate risk is the result of two factors: *the rate position* which is represented by the different lines/positions of the balance sheet which are depending on the market developments and the *uncertainty concerning the interest margin*.

The classical instrument of measuring the rate position is given by the rate gap or the rate impulse, which express in fact the difference between those assets and liabilities which rate is varying within a certain period of time, being thus called sensitive. The rate risk primary on the nature of the rates recorded by the different lines/positions of the respective credit institution balance sheet, some of them being fixed while others are variable. A rate is considered as fixed if, within a certain period of time, its size is not influenced by the changes occurring on the market. The variable rate is *considered that rate which is indexed periodically indexed or over random intervals*, depending on the monetary market evolution.

Depending on the ratio between the assets and liabilities, with fixed and variable interest, a bank may be on a *short position*, if it holds a portfolio comprising more liabilities with fixed interests than assets of the same category, in which case the bank is taking the advantage of an upward trend of the rates on the market. Thus, the bank has its liabilities blocked at a relatively low level of the interest while its assets will take the advantage of the favorable market situation. On the opposite situation, the bank is *on a long position* which, from the profitability point of view, is corresponding to the periods of return of the interest rates.

The risk of an adverse variation of the interest rate is present in both cases and consists of the change of the market value, or the updated

value of the claim or debt of a fixed rate of interest. A neutral position would cancel the risk without involving, however, the immunity for the bank while it hampers the banks from speculating the rate variation to its benefit.

In practice, the non-uniform changes of the interest rates are quite frequent and affect the *interest margin*, a yield indicator which provides an aggregate image of the ratio between the income achieved out of interests and the expenses involved by the interest payments. Irrespectively the form of expressing this indicator, the baking interest margin defines the bank capability to cover its expenses.

## **2. Methods and techniques used by the interest risk management**

The management of the interest rate risk assumes both the setting up of strategies, policies, techniques and the undertaking of concrete steps meant to maximize or, at least, to stabilize the bank margin, the difference between the income out of interest and the expenses with the interests, under the circumstances of an acceptable level of risk. In general terms, the management of the interest rate risk is including different policies, actions and techniques which a bank is using in order to reduce the risk of diminishing its own net capitals, as a result of an adverse evolution of the interest rates.

The system utilized by a bank for measuring the interest rate risk must identify all the sources generating this kind of risk and must be capable to evaluate the effects implied by the interest rate changes on the banking profit and the economic value of the credit institution. The system must be an integrator one so that the management of the interest rate administrates the assets, the debts and the positions outside the balance sheet which are affected by the interest rate fluctuations, as well as all the products and business lines the bank is dealing with.

### **The techniques of evaluating the interest rate risk**

*Table 1*

<b>Period</b>	<b>Characteristic</b>	<b>Market capital value</b>
1970-1980	Indicative	Long term analysis
1980-1990	Determinative	Simulations
90-up to date	Stochastic	Value at Risk

The specialized literature and the banking practice have developed several models meant to measure the interest rate risk:

- the interest gap model;
- the duration model (duration gap);
- stochastic and dynamic simulations.

These models are recommended by the Basel Committee also, aiming to develop a standardized model to be used by the regulatory authorities in order to evaluate the exposures at the interest rate risk.

The starting point as for drawing up a modern strategy of interest risk management, which may be focused on the assets and liabilities management, is given by the *gap management*. This is focusing on the management of the net income out of short term interests, in order to gear it. The interest rate risk is given by the difference of the gap computed at different intervals of time, on the basis of the aggregated balance sheet data. Every gap value is then analyzed, in order to establish the influence of the interests change on the net income out of the interests,

The gap method used for the analysis of the bank exposure to the interest rate exposure is a practice preponderantly used at the level of '80-'90, aiming the allocation of the assets and liabilities by maturities intervals, the balance sheet component being classified as sensitive to the interest rates and non-sensitive to the interest rates. The disadvantages of this method, materializing in the difficulty to chose an optimum interval, have been eliminated by the *re-evaluation of the interest rates* or, to be more specific, by identifying the point where they can be changed. This approach assumes that, by re-evaluating its balance sheet, the bank would take maximum of benefits out of the expected variations of the interest rates fluctuations, such a re-evaluation being meant to divide the re-evaluation intervals, depending on the duration, in three categories: on short, medium and long run. As the difference of re-evaluation has a marked static character, the efficiency of this method is entailed by the impossibility to anticipate the impact of the financing strategy change on the interest net margins but, meantime, it secures an optimum adjustment of the assets/liabilities structure so that the desired gap is achieved.

A more recent form of the *gap model* consists of the *dynamic* approach of the gaps, which provides the banks top management with more detailed data, resulting out of the simulations being achieved.

*The simulation* is used for both the gaps management and prognosis drawing up meant to reflect the sensitiveness of the net income out of the interests as to the interest rate change. In terms of banking practice, there are static and dynamic simulations being used. The static

simulations are taking into account only those changes arising as a result of the interest rates possible changes, on the elements of and out of the balance sheet which are existing presently, while the dynamic stimulations which assume the drawing up of a number of scenarios concerning the interest rates change, from their development in time up to the client behavior and the exogenous factors which are influencing the occurrence and the development of the interest risk (the existing economic risk, the type of economic, monetary and financial and exchange policies being promoted etc.) The dynamic simulations are integrating numerous variables, being thus useful for the measurement of the sensitiveness of the net income out of interests, of the gains and of the capital to the key-element changes, the accuracy being dependent of the objectivity of the entry parameters. This model eliminates the disadvantages of the gap model of duration, connected to the costs being induced by the need to let the balance sheet restructure as well as by the facts that immunization is a dynamic issue. Thus, the duration of assets and liabilities is permanently changing, sometimes even instantaneously, as a result of the interest rates volatility, the ideal situation implying that the bank is restructuring its balance sheet and achieve the immunity every time the market rate changes.

The covering instruments against the interest rate risk allow the quantitative measurement of the present position of the balance sheet as well as the comparison between the capital being placed and the capitals being borrowed, most of the time these one bearing different characteristics. Irrespectively which instrument is used, the immunization is hard to be achieved.

*The present, or patrimony, value* of a placement with a given nominal interest, is expressing the value it should have in order to induce the present interest rate of the market.

*The average life duration* allows the comparison between the interest rates for the placements or borrowings of different characteristics. The average duration is that duration the initial investment should have in order to produce the same level of interest as the level achieved for the granted loan.

$$V = \text{Sum } T_j F_j / \text{sum } F_j$$

where  $t_j$  is the time interval which separates the maturity moment from the moment the calculation is made;  $F_j$  the capital flow by the moment  $j$ .

The derived duration of the average life takes into account the interests corresponding to the flows updated to the market interest level and the reinvestment possibility, as follows:

$$D = \frac{\sum_{j=1}^{j=n} tjFj(1+T)^{-tj}}{\sum_{j=1}^{j=n} Fj(1+T)^{-tj}}$$

The equation is expressing the term by the end of which a loan (principal and interest) which is reimbursed at maturity is producing the same actuarial yield. Under the circumstances, the actuarial yield equals its nominal interest rate, irrespectively the market fluctuations, being thus immunized against the interest rate risk. This duration applies particularly to the bonds, as it is in fact a temporal indicator.

In case of a bond with a coupon  $F_j$  corresponding to a time period  $t_j$ , where  $j = 1, 2, 3, \dots, n$ , and market interest rate equaling to  $T$ , the bond would be immunized by the time  $D$ , calculated as follows:  $\delta(D, T) / \delta T = 0$ ,

The duration  $D$  is set up by the capitalization of the previous flows  $F_1, F_2, \dots, F_k$  at a given interest rate  $T$ , as follows:

$$V_1 = F_1(1+T)^{-t_1}(1+T)^D + F_2(1+t)^{-t_2}(1+T)^D + \dots + F_k(1+t)^{-t_k}(1+T)^D$$

$$V_1 = \sum_{j=1}^{j=k} F_j(1+T)^{D-t_j}$$

The residual value or the market value of the bond, as estimated within the period  $D$  at an interest rate  $T$ , is given by the relation:

$$V_2 = F_{k+1}(1+t)^{-(t_{k+1}-D)} + F_{k+2}(1+t)^{-(t_{k+2}-D)} + \dots + F_n(1+t)^{-(t_n-D)}$$

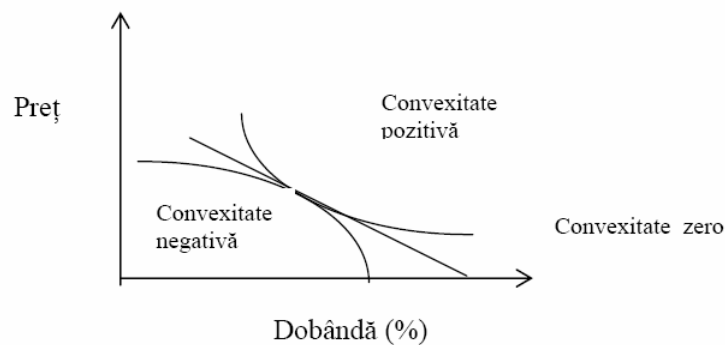
$$V_2 = \sum_{j=k+1}^{j=n} F_j(1+T)^{D-t_j}$$

The total value of the bond, including the capitalized flows as well, is given by the following relation:

$$V = V_1 + V_2 = \sum_{j=1}^{j=n} F_j(1+T)^{D-t_j}$$

By deriving against  $T$  and solving the equation we find out that duration which allows the immunization of the bond. This approach considered that the market interest rate is constant also, which situation is not to be found in the real world. This aspect would be the main defect when setting up duration. The simulations have shown that, if the market interest rates do not change too much as comparatively those included by the model, the calculated duration provides a satisfactory immunization.

The *duration convexity* is expressing the duration change under the incidence of small variations of the interest rate. If the durations are adjusted but their convexities are not the portfolio is not immunized against ample fluctuations of the interest rate. The convexity values may be positive, negative or equal to zero. In case of a positive convexity, we find that the asset volatility is higher.



**Figure 2.** Duration convexity as the function of interest rate

The duration is varying depending on the present value of the income flows, which value is influenced, at its turn, by the interest rate variation. This is the reason for considering the duration as a *sensitiveness indicator*. This indicator varies along with the interest rate for which it is calculated but it should be not considered that a low interest rate induces a minor risk. There is a category of bonds which sensitiveness is null theoretically, such as the variable interest bonds.

The sensitiveness measures the interest rate risk and represents the relative variation of a financial asset price as a result of the change of the interest rate by one percent.

In order to quantify the sensitiveness of a bank against the interest rates fluctuations, the *Duration analysis* can be used, as it gives the market value change for a position or a financial-banking instrument as against the interest rates variations. *Duration* is actually a model based on a quantitative analysis which, in classical for, allows the sensitiveness of the active and passive elements as against the interest rate fluctuations to be measured. A recent approach of the sensitiveness against the interest rate consists of using the *modified duration*, which measures the changes on the market values of an asset against the interest rate variation.

$$\text{Modified duration} = \text{Duration} / (1 + \text{Yield by maturity})$$

where  $\text{Duration} = \sum (t \times PV(t)) / \sum PV(t)$ ,  $t$  time;  $PV$  – updated value of a future cash by the moment  $t$ .

Percentage modification of the asset price = - *Modified duration*  $\times$  *interest change*

The praxis underlined the efficiency of using the *Modified duration* from the following perspectives:

- The possibility of fixing the asset which is generating the largest loss depending on the periodicity of the interest payment or on the longest maturity of the interest payment;
- Utilization as complementary instrument in order to set up acceptable stripes within which the exposure duration may vary.

The *Duration model* became the most utilized model of quantification for the interest risk for the asset/investment portfolios which imply that the individual values of the Duration indicators for each asset to be weighted by their market value.

*Modified Duration for the portfolio* = *Portfolio Duration*  $(1 + \text{portfolio interest})$

or

$$\text{Modified Duration for the portfolio} = \sum MD_i \times W_i$$

where: MD i the Modified Duration indicator for the asset i and W i the market value for the asset i considered as weight within the model.

Contrary to the classical models (gap or simulation) *Modified Duration for a portfolio* provides a long term perspective but, since the risk is measured by computing the updated value of all the assets, debts and positions outside the balance sheet, it is not used on a large scale for managing the interest rate risk.

#### 4. Using the swap contracts for the interest rate management

In the frame of the interest rate management, an important position goes to the financial derivative instruments, mainly to the swap operations because of the advantages they are providing: high liquidity, flexibility and accessibility. The swap is choiced as an instrument for the management on the long run of interest rate, being therefore associated to the placements. The fact that the banks may chose between attracting resources of variable rates and granting loans with fixed rates and vice-versa represents the very reason of the using the interest swaps.

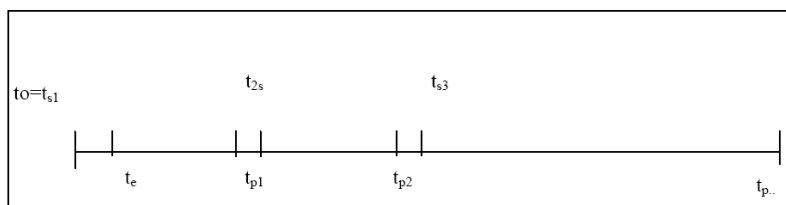
The interest rate swap is considered as being the simplest form of a swap operation. The actual forms of the interest rates swap are: *coupon swap* (plain vanilla swap) and *basis swap* (index swap).

The interest rates swap due to the coupon (coupon swap) includes Fixed to Floating Interest Rate Swap, which implies an exchange of contracts with fixed interest against a contract with variable interest and Floating to Fixed Interest Rate Swap based on an opposite exchange.

In practice, *floating interest rate swap* (variable interest against variable interest) has three forms, depending on the exchange type:

- swap with variable interests but with different maturities on the same market (for exemple 3 months LIBOR against 6 months LIBOR);
- swap with variable interest linked to the same maturity but executable on different markets (for exemple 3 months BUBOR against 3 months LIBOR);
- swap with variable interest against the average interest, for the same maturity and the same (for exemple 6 months LIBOR against 3 months weekly average LIBOR).





**Figure 3.** *The succession of the temporal elements due to the swap contract on the interest rates*

where:  $t_0$  is the transaction date/contract;  $ts_1$  is the date of fixing the floating interest for the first time (in the case of the standard swap  $t_0 = ts_1$ );  $t_e$  is the moment from which the interest start actually to be computed;  $ts_2$ ,  $ts_3$  are the data of reference at which the floating interest rates are set up for the following periods;  $tp_1$ ,  $tp_2$ ... are the discounting dates for setting up the net payments due for the respective periods.

The evolution of the swap operations market, irrespectively the transaction types, proved to be very dynamic and flexible as it managed to accommodate to the more and more requiring demands of the market players, which guaranties the active part the international market is playing in this respect.

In order to give a conclusive example, let's consider a swap contract on the interest rate having the following characteristics:

- Notional (principal) 50 million RON;
- Fixed interest rate 15% pa;
- Floating rate BUBOR flat;
- Floating rate premium: 22 % pa;
- Calculation basis for the fixed rate: actual/360;
- Calculation basis for the floating rate: actual/360;
- Transaction date: 01.03.2007;
- Beginning date: 03.03.2007;
- Maturity date: 03.03. 2012;
- Payment frequency for the fixed rate: yearly – by each 03 of March or the first working day after 03 of March.

The cash-flows due to the calculated period under the conditions of BUBOR rate for the following 4 periods estimated at 19,00%, 17,0%, 14,20% și 13,00% are given below:

amount 50 mil. Floating rate fixed rate 15,00% date, days, fixed payment, net payment

Data	Fix payment	Net payment	50 mil. sum	Fluctuating rate	Fluctuating payment	Fix rate 15%
01.03.2007		365				
03.03.2007		364	22,00	11.122.222,23	1.686.870,37	9.435.351,85
02.06.2008	(L)	365	19,00	9.631.944,44	7.604.166,67	2.027.777,78
01.06.2009	(L)	364	17,50	8.847.222,22	7.583.333,33	1.263.888,89
01.06.2010	(M)	365	14,20	7.198.611,11	7.604.166,67	-405.555,56
01.06.2011	(M)	365	13,00	15.816.666,67	7.604.166,67	8.212.500,00

**Source:** author's calculation.

Thus, the payer of fixed rate entered this swap because he anticipated an increase of the interests in RON, while the reason for the payer of floating rate consists of the anticipation of a decrease of the interest rate.

Let's consider that the company (X) enjoying a good rating, can borrow over 5 years, at the floating BUBOR +3% or at the fixed rate of 20%, while another company (Y) quoted with a lower rating can borrow over 5 years also at the floating BUBOR +5% or at the fixed rate of 25%. Let's assume that X prefers to borrow at a floating rate (BUBOR +3%), while Y prefers a fixed rate (BUBOR +5 %) and bears an additional risk premium of 2%.

The alternative which would favor both companies consists of the conclusion of a swap contract under the following conditions:

- X borrows at the fixed rate of 10%;
- Y borrows at the floating rate of BUBOR +5%;
- X and Y conclude a swap on the interest rate where X is payer of floating rate and Y is payer of fixed rate.

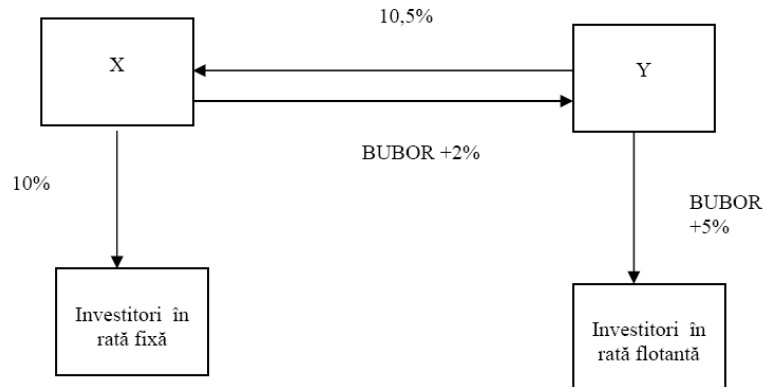


Figure 4. Swap evolution scheme

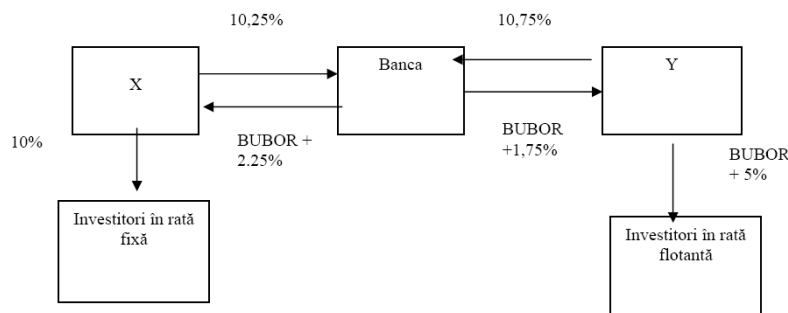


Figure 5. Scheme for a swap spread out by the bank

Under the terms of this scenario, all the parties would take advantages, i.e.:

- X is financing itself at + 2%;
- Y is financing itself at the fixed rate of 24%;
- The bank is gaining 0,5%.

The option as to utilizing the swaps as instruments for covering the interest rate risk results from the possibility of modifying the exposure at

the interest rate risk, for both the active and passive elements. On the active side of the balance sheet, by the means of the swap the placements at fixed rate may be turned into placements at floating rate (by buying a swap) or those at variable rate may be turned into placements at fixed rates (by selling a swap). As for the passive elements, by buying a swap the debts at variable interest rate may be turned into debts at fixed interest, while by selling a swap, the debts at fixed rate may be turned into debts at floating rates.

The management of the interest rate risk by swap contracts can be achieved also at the level of the entire banking balance sheet. Under such circumstances, the net exposure to the interest rate shocks is directly connected to the gearing effect, the duration and the size of the balance sheet active. Thus, the modification of the net gain recoded by the bank will be:

$$\Delta VB = - (Da - l \times DL) \times A \times \Delta r / (1+r)$$

Where

$\Delta VB$  – the modification of the market values of the banks own capitals;

$Da$  – the active duration;

$DL$  – the debts duration;

$l$  – gearing effect,  $A$  – actives;

$l$  – debts;

$r/(1+r)$  – interest rate shock..

In practice, the risk management for the entire balance sheet is better known as macrohedging with interest rate swap..

*The contracts of the kind cap, floor and collar* allow an efficient management of the interest rate risks and, in comparison with the swap contracts, provide with the advantage of granting the investor the possibility to benefit of the favorable variations of the interest rate along with the limitation of the eventual losses.

A cap contract is a series of contracts (call options on the interest rate) bearing the maturity dates corresponding to the payment dates on the account of the future interests due for an existing credit. A cap is a group of call options on the interest rate for which there is an initial premium to be paid, equal to the sum of the premiums due to the individual caplet contracts.

For instance, a bank has a loan of 400 million USD contracted on 01.05.2006, for a period of one year, the interest payments are based on 3 months LIBOR. If the respective bank anticipates an increase of the interest rate and wishes to fix its payments at the current rate of LIBOR-90 by  $Lo = 10\%$ , it will buy a cap for a premium of 12 million dollars, with an exercise date by 01.08.2006 and 01.12.2006. The cap premium is 0,3% of the nominal value of 400 mil. USD. For each of the expiry date (t) for the caplet contracts, the cash payment for the following 3 months will be:

By the moment (t+3 months) = 400 mil USD. $\max \{0, \text{LIBOR } t - 0\} \times 90/360$ .

The first payment by a (t+180) is calculated on LIBOR by t+90 and brings an increase of the cap payment amounting 71556 USD. The net cash-flow of 102222 USD represents the payment of the interest to the loan.

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## THE BASIS OF THE CHANGE THROUGH CREATIVITY, RESPONSIBILITY AND HOPE



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**Abstract.** The text is analyzing the changes occurring by creativity, responsibility and hope. There is a profuse photographic incursion within the concept of humanity and individual the text evidences, emphasizing the contemporary transfer of the sense of responsibility. A world without borders, placed within the context of the North-South or East-West relationships, leads to the conclusion that the common future might be better. There are also aspects such as the society, the environment and the labor location being approached, as interrelated categories which should lead to the following aphorism "healthy people and healthy community through healthy organizations, in the frame of an healthy environment".

**Key words:** individual; environment; organization; community; courage; economy; family; hope; responsibility; borders; expertise; accumulation; conscience; spirituality.

**REL Classification:** 10J, 19I



The vision of the new economy, which we name „the economy of rationality and hope”, has its origins into the respiritualization of the human individuals and that of the communities where they work to live healthy, as generations that co-exist and alternate inevitably.

Now at the beginning of a new way in the era of the our microcosm time, when a new century, the 21<sup>st</sup>, already has integrated us in the evolution towards a new spiritual-human experience, the old one, the sole from which we can learn to unlearn, to destroy creatively and to

hope, obliges use to transform the accumulated and globalized serious difficulties into challenges that we can face through a new faith generated only by the individuals' inside authority, of the communities where they manifest themselves, as social beings.

The paradox of the Chinese curse to live in times with interesting changes is that, despite the accumulation and the globalization of some serious results connected with the daily disappearance of hundreds of species from the planet surface, the multiplication of the holes in the ozone layer by a speed double than that anticipated by the most pessimistic anticipations, the starvation of thousands of people each day, the progress of the weapons of atomic destruction of the natural-human life many times, as only one wasn't already sufficient, the lose of the control concerning the demographic rate at global scale, „the population of the under-developed countries in the world says that desires a culture of the same type. So, the destructive forces are supplied from themselves. As the African scientist and pedagogue Mtombe Mpana says «the American dream became the world's nightmare»” (Ray, p. 3).

In order not to live the same experience also in the century we entered into, it is necessary to respiritualize the creative destructions we need, to unlearn as quick as possible and more profoundly to use the knowledge achievements against the natural-human life, to learn to assume the responsibility with creativity, compassion and community spirit, to believe and to hope in the power of optimism given by the authority generated by the change of the human being from inside towards outside.

The critical-visionary analysis of the old economy spirit that characterizes the last century shows us that in the world new gulfs have evolved, developed and deepened, that reveal between where we are in reality, as people, institutions, organizations etc., and where there are our perceptions concerning this thing.

The new dimensions acquired by the space and the time of our co-existence and succession as generations leave their marks onto the panorama of the ways the people perceive and report themselves to the social, educational, cultural, economic and political-community reality.

The perception and the report to this complex reality that integrates quickly and more and more directly the new characteristics of the space and time that become a common good for the lived life, work and love, arises the problem of the human mind respiritualization, as an endogenous



factor of having the awareness of the change from inside towards the outside of the environment where we co-exist and succeed as natural-human and social-global beings.

From the respiritualization of the human being one can pass to the *contemporary transfer of conscience*, to the “change of the global mind” – as support of the perception, relation and proactive action *in the name of maintaining the human identity and diversity of the forms* where this manifests in the space and time of our microcosmos.

By means of the worlds we perceive, relate and act as natural-human and social-community beings, the process of “breaking” that must mark the making conscious the contemporary transfer of responsibility is built through the *respiritualization of the values belonging to the global citizen acting locally, thinking universally*, both in the *family of love* and in *that of work, faith and hope* for better as well.

*The family of love is, in our opinion, the family* where the human individual find, as various forms, the natural-social-spiritual framework of fulfilling the life lived near to loved ones, providing and reproducing the human life related to the model assimilated through traditions, culture and faith by various communities. In the most large sense, the love is a positive feeling, that “includes the gratitude, the respect, the trust, the admiration for the remarkable achievements that, all together, inspires the goodwill and the friendship. (Willis, 1998)

*The family of work is the organization*, where the human individuals co-operate by putting their services at the service of the utilities production for necessities, during the active period of their lives, receiving in return incomes which allow them to manifest their liberties to chose upon the various markets where the money is the support of buying.

*The family of faith and hope is the community society*, as urban and rural localities, countries, where the individual can manifest their options as citizens, for their good and that of the communities where they live an unique and irreversible spiritual experience, trying to keep under the social control the risks generated by the evolution of the nature and that of the society from our microcosm in conditions of incertitude. The struggle for putting the achievements of the science and the experience in the service of the preventing and keeping under control by the community the great risks generated by the evolution of the natural-human and social life represents, in our opinion, the most important task of the countries and

institutions after that of providing the prosperity and the well-being of the citizens.

These three families where the human individuals live each the experience of the own transition through the human life find, in our opinion, both the faith and the hope in the *humanity* as well. In this sense, P.H. Chamber Louwe said that "...we can aspire for ourselves to a better well-being, to better pleasure, to more joy, to more knowledge, but we have hope only in the mankind". (Chamber Louwe, 1998, p. 334)

The fact that the same human individual lives his unique experience of life in all these three families, between these should not exist, from the perspective of the fulfilling the lived life, nothing else than a full harmony between the values of love, values of work and the values of the faith and hope in mankind. In the reality of the lived life, these three values are in fact many times contradictory, being in an irremediable incompatibility at the present level of the politic management and that of the institutions corresponding to this management, upon national and international level.

By means of this harmony the foundations of the evolution upon the normal and desirable sense are laid, which, in the vision also of Mircea Eliade, was considered as being connected with the need "to use it consciously and gloriously, in as much levels as possible, to accomplish and to complete continuously, to find the ascension, not the outer surface, a way for achieving all the virtues and to point out not an intelligence or an assembly of instincts, but the man". (Eliade, 1991), p. 19)

The new complexity of interdependences in which the human individual finds himself at the beginning of the new century arises the problem that *those three families where this lives his experience of life form an whole*, whose components – love, work, faith and hope – must work not only from the perspective of the man's fulfillment, his permanently achieving and completing as natural being meant to live in the community-society, in an environment given free of charge by the nature of our microcosmos.

For this reason the Great Change at the beginning of the XXI<sup>st</sup> century must start with *the mastery of the future today*, by means of the *contemporary transfer of conscience concerning the responsibility from the perspective of the whole* that forms the lived life, the work and the love, in an environment we wish to be healthy as family, organization, community and ecology.

It is a matter of the health concerning these three families where the individuals spend their live, the *Family of Work* – through the organization institution, being as important as the *Family of Love* and the *Family of Faith and Hope in the Makind* as well. The health of these three families where the individuals follow the way in life is essential for valuating the respiritualization of the conscience concerning the responsibility of the human individual, in all his conditions.

In order to have *healthy families, healthy organizations* and *healthy communities* we must to have the same criteria of valuation concerning the state of health, emerging from the need of the human individual to accomplish himself, as biological and social being, as natural-human spirituality, as mankind.

If we take into account the fact that all these forms of health concerning *our common whole, in which the human individual lives, are absolutely connected with a healthy environment*, then results obviously the fact that *the businesses of the lived life must not have other criteria of valuation*.

*The Family, the Organization, the Community and the Environment where the individual co-exist and succeed inevitably form today an whole* that faces an evolution more and more rapid towards a borderless world, where the power and the strategy interconnect upon more and more levels and for more and more remote times, this implying a “*new awakening*” in the struggle for surpassing the obstacles on the way of the human potential – as paradigmatic element necessary to the transition into the Era of Practical Responsibility, both with individual character, and institutional-community as well.

According to Ahmae Kenichi, *the borderless world* (1990) has arrived, where as the global citizens we act locally on the basis of an universal thinking for a better common futures, which is more and more dependent on that is happening in North and South, East and West, precisely as a manifestation of the new forces generated by the value of the global interdependence within an interconnected society, where the speed we communicate and travel almost have cancelled the natural restrictions of the time and space belonging to our microcosmos.

A part of the world concerning the human businesses unfolds in the *Family of Work*, where the people, grouped in organizations, fulfill one of the imperatives referring to the lived life, namely the work. Now, at the beginning of a new century, *the organizations of work*, through

their global dimensions and power affect the economic, political and social forces, affect the culture and the traditions being in a position to generate “social-earthquakes” which, if are not kept under control, will transform us from a “*Borderless World*” into a “*Hopeless World*”.

Exactly due to the new global extension (Barnet, Muller, 1974) and the new power acquired by the multinational corporations, we are now confronted with a “new awakening”, a “revolutions of expectations” which will come only from the *respiritualization of their intellectual capital*, towards the “creativity through responsibility”.

The awareness of the new form of property emerging in the future, as global properties, arises the question of *global serving*, as principal function of the new multinational corporations, where the “Making Peace in the global State” will be connected with the elimination of the “structural violence” that exists today in the world as hunger, lack of shelter, social injustice etc. (Brown, AcAfee, 1981)

The extent and the power that serve as basis for the future corporations arise also the question of making it conscious of the “*its identity as generator of moral effects*” by means of the new environment it develops for the Family of Work, where the corporation morality becomes one of the most important forces meant to consolidate and complete its goals in a borderless world, but with faith and hope.

Through the capacity to generate moral effects over the employees’ life and, in this way, over the communities, the new multinational corporation will play a role more and more active in emergence of the “transindustrial” society.

The Family of Work, as Family of Businesses generating utilities for necessities, through the creation capacity generated by the *respiritualization of the intellectual capital* will have a positive and valuable, constructive role in the transformation of the global society which, beside the Family of Love and the Family of Faith and Hope, will represent the three human power put at work at the service of the community, according to the principle “win-win” for MAN, Society, Organization, and Environment, for the functionality within conditions of health for our common whole.

In this position of the multinational corporation, the Family of Work in the organization will become a community of well-being, being more and more conscious of the necessity to integrate the employees’ families into the complete set of corporative shareholders, generating in

this way the values of the co-dependence and dependence that, put at work, will allow to reach “higher levels of honesty, sincerity and, in the last resort, well-being”. (Maynard, Mehrtens, 1996, p. 145).

The challenges of the co-dependence and dependence in the Great Family of Work generated by the multinational corporation in the XXIst century will be at the basis of achieving the new form of economy, that of a “live economy” where only people matter, providing the accomplishment in all these three family, namely those of love, work and faith.

The challenge of the humanist economy, as live alternative economy, will transform the multinational corporation also into a model of concern for the viability of the environment, the Earth being considered “their supreme client”, this representing the most profound change in the New Era of Practical Responsibility, where we must provide products and practices in accordance with its exigencies.

*The economy, as the people, the society and the environment matter*, represents, also in our opinion, the backbone of the businesses in the XXIst century, to which will be added “*the democracy at the working place*” – as practical, spiritual-human way of self-administration, participation and property of the working place, where it is included the supreme value of the work – the accomplishment of the human individual as personality with a creative responsibility.

By the strategic planning, that will become indispensable for the businesses in the XXIst century, the great corporation will be concerned with the integration in the values of the durable, common future, also elements with ethical character, such as those concerning the “necessities of the generations that co-exist and succeed”, in this vision will be concretized the new function of the multinational corporation, without which the principle “win-win” is unaccomplished.

The extent and the power of the multinational corporations will transform also their community, a system of rewards resulting from the interaction community-organization, of which all the participants will benefit.

At the present time, the communities are not prepared to accept the new role of the multinational corporation, but as it will be proved in act and fact the new practical responsibility of the business organization, these Families of Faith and Hope will unite with the Family of Love and the Family of Work under a unique common requirement: *healthy people*

*in healthy communities, by means of healthy organizations in a healthy environment.*

The evolution of the human-natural and social life shows that as the changes accumulate in the time and space of our common existence, the necessary critical mass will be reached in order to generate a new leap of the change. At its basis there is the most powerful force, namely our moral courage to assume the new responsibilities of our common evolution, to manage the future by means of the actions taken today. This moral courage must defeat "the conspiracy of untruth" within which we live when we lie by omission, passively, by embellishing the imperfections, or by hiding of some essential aspects of the life connected with the love, work and faith.

The change so necessary, from the perspective of the requirements involved by the life of the human individual in these three families, is done always from our inside, and it is the result of managing our own life, as first form of human responsibility, assumed individually.

"The transformation, the real change – says Stephen Covey, it done always «from inside towards outside» [...], it evolves from a work that acts at the roots, affecting our way of thinking, the fundamental paradigms that define the character and provide the lenses through which we see the world". (Covey, 1996, p. 19)

In order to adapt ourselves to the changes brought by the evolution in the century we entered into, within the framework of those three families where the man *loves, works and hopes*, it is essentially to pass from the "*passive honesty*" to the "*active sincerity*", to create those environments for the co-existence and succession of the human world's businesses where we feel secured and where we can assume the responsibilities, with full knowledge of the facts.

In the new vision, *the role of the corporation*, defined by goals, motivations, values, interested parties, prospects and fields of action, changes radically, becoming a *global servant*, with a responsibility at the level of our common whole – MAN – Society- Environment. In this context, the *corporation wealth* will be defined through the way the community property, the spirit of creativity and social accounting serve to the accomplishment of the life's quality in these three families where the human individuals are integrated as biological, natural and social beings.

For exerting such a role provided by the extent and the power in the name of improving the quality of the natural-human and social-

community life, *the structure of the corporation* must have a community character, within which each participant at the Family of Work is free to be a leader or a subaltern, having the responsibility of participating to the successes and failures of the businesses.

Through the new configuration involved by *the community of the corporation*, there are laid the basis of the healthy values generated by the open interdependencies between the people, animated by the sentiment that their life is in a direct relationship with the functionality of the company, with the efforts of those united through the goals to be reached by means of the businesses from which they are a part.

The new environmental orientation will treat the Earth as a thing that deserves to be served, of which life depends the life of corporation, that of the human communities, generally, the life of our common whole that became globalized due to the unity of the goals aimed by all stakeholders: Man, Society, Organization, Environment.

In harmony with these integrating vision, *the technological development through creativity and innovation* will arise the question of the organization performance from the perspective of *rationality and hope*, principles inexorably generated by the limitation of the means they dispose of and by the actions exposed to the sign of incertitude, that find in the management of the human being both the necessary energy for starting the change, and its supporting in accordance with the accomplishment of the individual human life within healthy communities and in a healthy environment.

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# THE ROLE OF HUMAN CAPITAL IN THE DEVELOPMENT OF THE EUROPEAN MARKET



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*Abstract. For Romania, one perspective of matching with the already existent competition on the European Union markets, as stipulated by the Copenhagen Summit works, 1993, might be to encourage the legislation to cut costs of getting in and out one market. In order to meet such aim, we use the orientation given by measuring the economic and social progress, in the development perspective needs, by the set of indexes recommended by the international organisms. Trying to be pragmatic about opened and relativistic market, we synthesized a case-study, belonging to West Romania Region.*

**Key words:** competition; development; opened and relativistic market.

**REL Classification:** 8N



## 1. Introduction

The spring-concept of human capital lies back in the history of economic thinking, exegetes finding the first definition into the Adam Smith's *Wealth of Nations* (1776) as the acquired and useful abilities of all the inhabitants or members of the society. The acquisition of such talents, by the maintenance of the acquirer during his education, study, or apprenticeship, always cost a real expense, which is a capital fixed and realized, as it were, in his person. Those talents, as they make a part of his fortune, are inclosed in the society to which they belongs, too. The improved dexterity of a workman may be considered in the same light as

a machine or instrument of trade which facilitates and abridges labor, and which, though it costs a certain expanse, repays that expanse with a profit.

If the capital concept describes the nonhuman instruments of production, the human capital considers that education and training are worth what they cost, and we could even estimate the human capital stock using the mentioned expenditures. In a modern society, it is legally mandatory to add health-care costs, social protection costs as a constitutive part of the general human resources.

The common flow through macro-economy turns the investment in education, training and in maintaining the labor into a *return in the original investment*, which helps in appreciating whether the investment is worthwhile, or we have a profit. This investment is made in individuals, from different-owned sources (individuals, families, private and government) and it is expected to generate higher incomes for the employed in the future, big profits for the employer, larger benefits for the society.

In the globalization and integration context, this common expectation about the human capital related to the value flow can have spectacular augmentations, carried by the trans-national companies, firms, as economic vectors of growth and development, regional development included. This actually happens in Romania as well, because the current global behavior of the companies generalizes *the set of best economic practices*.

Within the European space, the liberalization of labor, understood like the personal freedom of being employed wherever inside the labor-market, while assuming a high degree of liberty in decision, gathers under the law control the economic activities of the agents, no matter their strength, in order to insure a competitive market and a competitive environment, for the increasing quality purpose.

United Europe has regulated this by *The White Paper on Growth, Competitiveness and Employment: the challenges and way forward into the XXI-st century*, Brussels, December the 5-th, 1993. For Romania, one perspective of matching with the already existent competition on the European Union markets, as the Copenhagen Summit (1993) stipulates, might be to encourage the legislation to cut costs of getting in and out one market. In this respect, the public authority is concerned, using the legal tools, for fixing the market competition and release the potential benefits out of it.

Regarding the regional imperatives of the economic organization, in 1998, our country has adopted The Law no. 151, of regional

development, establishing the institutions, the objectives, the competencies and the specific instruments required by the regional development policy of Romania.

This regulation sets up the 8 Romanian regions of development, corresponding to the statistic level NUTS II, formed through the voluntary association of the counties. This euro-regional organization does not involve a juridical responsibility of the new shaped parties.

Timis County, the object of our case-study, belongs to West Romania Region, number 5, uniting Arad, Caras-Severin, Hunedoara and Timis Counties.

It has 32,034 sq.km. and 2 033 000 inhabitants. This region outstands because of its highest degree of urbanization: more than 60% of the population is urban; a significant index is the low difference (0,7 year) between the life expectancy in urban and rural areas of West Region, which means almost similar quality of life and living standard for rural and urban places.

Measuring the economic and social progress, in the development perspective needs a set of indexes was recommended by the international organisms. Among them, *Human Development Index* (HDI) is a composite index, measuring the average acquisitions in three fundamental dimensions of human development: the average life expectancy at birth and the health level according to the age, life expectancy index; the education index (adult literacy rate, combined gross enrolment ratio for primary, secondary and tertiary schools); a decent standard of living: gross domestic product (GDP) per capita.

For Romania, in 2005, this calculated index had the value of 0.773, where life expectancy index was 0.76; adult literacy rate, combined gross enrolment ratio for primary, secondary and tertiary schools was 0.88; GDP per capita was 0.68. The GDP rank (-) HDI rank was 9, a medium place among nations for our country.

A balance between the human capital and the regional development results in a solution in the domain of market equilibrium, because the problem of the competition at the continental or global area could be treated from the point of view of the so called *disputable* markets, a phenomenon which is actually happening in a various degree at the deciding authority's level, in the direction of a liberalization that can be administratively imposed to the markets.

## **2. The theoretical debate**

The theory of the disputable markets, appeared in the USA, but developed also by others European authors, no longer puts in front the number of participant firms at the transactions, like in the classic theories, that were looking for the objective of the best allocation of the resources, due to the fixing the goods and services prices at their marginal-cost level and a permanent stimulation in order to achieve the minimum average cost.

This theory of contestable markets is based on the observation that it is no longer important the number of the competitors to determine the competitiveness degree and the behavior of the firms, but the possibility, restricted or not, that companies outside the market could have in order to step in a market and to have an influence on the pre-installed firms from the market.

To have a contestable market, some conditions must be fulfilled:

1. The freedom of stepping in the market, a characteristic common with the perfect market;
2. The freedom of getting out, meaning how easy the firm can leave any type of market.

This conception about the market substantially contributes at the increasing the role of the freedom of leaving the market.

For a new company to try competing the already installed companies on a market is not enough to have the freedom of stepping in.

To step in the market, the company has to invest in marketing and technical studies, equipment, promotions. Because many markets have economical, political, social or even natural risks, the companies aim to spend as less as possible, not to waist money. If the company will not achieve the estimated rent ability in a short time, it will proceed to step out (exit) of the market.

When getting out, the companies have expanses that should be as low as possible: through paying off some initial costs, reselling the initial equipments, or redirecting them to other activities.

The smallest the getting out-costs are, the more attracted the competitors are to approach the market; the highest the getting out-costs are, the less contestable the market is.

The perfect disputable market is considered when the freedom of entering the market is total, and the firms getting out after a wasted tentative of compete risk no other costs but the normal pay off of the investments in means of production.

The authorities are able to help with a proper legislation and an adequate competitive behavior decreasing the getting out-costs that signify a null risk when entering a market.

In such a situation, the companies settled on the market take in consideration the *inside competitors* as well as the potential competition of the *outside competitors* in order to step in the market. On a contestable market, there might be one or more producers; they behave as they were in a perfect market situation, having a perfect competition, to escape the steady burden of the potential competitors.

On such a market, a monopoly is not able to get an over-profit all the time, in contrast with the competitor companies, unless it can handle the pushing entering of the new firms. On a contestable market with free input and null get-out-costs, any enterprise has the chance to come in the market for selling the same goods or services, at such a high price that allows over profits, and to take its share from the producers' incomes, already set on the market.

When the global offer is increasing on the market, the inside firms will have to feedback the pressure from the competition lowering the price, which will lead to the decrease of profits; this option lasts as long as on this sectors we get higher profits then in competition sectors.

When the getting out costs are negligible, the latest firm can leave again, as soon as the reaction of the others led to the price and profits lowering.

The presence of the company on the market lasts as long as the anticipated rent ability period lives.

If a large number of short presences of some companies on a market are noticed, (ghosts), then we have a destabilizing effect upon the rest of the competitors, and they will be forced to practice those prices in order to discourage the entering on the market, that is the prices allowing only a normal short-term profit, as we were on a perfect market.

So, if the market is perfectly contestable an oligopoly as well as a monopoly could practice a price as high as the marginal cost.

No matter the structure of the market is, the economic agents will only cash a normal, competition profit; the real or potential entering and outings on the markets making extra-profits will end diminishing them.

There can be verified the observation that the profit ratios in different sectors are independent of the concentration degree of the firms.

Some type of markets can hardly become contestable because of the huge fix costs, that obviously turn to waist when bankruptcy is imminent (like natural monopoly), or because of the property on a unique

technology or recipe, which is the case of the temporary technologic monopoly.

The most important consequence of the theory of contestable markets lies in the orientation of the economic competition policy towards the making and maintaining the contestability of the market, and in the mean time giving up the actions against the concentration of the companies.

The concept of *contestability* or *disputability* does not bring satisfactory explanations for all the complex macro-phenomena that arise on the macro-markets because all market relations are included in competition.

Large markets, like the European market, are explainable by the rigidities and deep segmentations, mathematically expressed by *the intrinsically and the rigidly characteristics* of the economic macro-structures. Such non-holonomic structures have been found to be true in mathematics and physics, and have a correspondent under the shape of the theories of the relativity of the physical spaces, demonstrated to be real by Acad. Gh. Vranceanu. On the labor market, this *vertical economic motion* is the objective cause of the human capital migration, standing as the basic trend for macro-phenomena.

### 3. Case study- recommendations

Having as primarily point the mandatory aspects regarding the European market rules we have run a case-study upon Timis county, *West Region*, urban area, medium level developed. We had in mind to identify the distance between the practice and the economic theory in the competition and market sphere, and also to recommend favorable solutions.

The company we studied was born by the fusion of state and private capital forming the start for its new social capital. The object of activity of the society is complex, mainly the acquisition and trading of the (crude) leather, of animals, production and trade inside and for the export of some specific products for processing leather and for other industries, obtained in the chemical processing of the sub-products (pepsin, amide), activity of fodder flour production (of meat, bones, blood), and industrial fats for inside markets and exports.

The administration Council of the firm is formed by Romanian and ships foreign citizens, the president is foreign citizen and he represents the firm in the relation ships with the current management of the company is

held by a director, Romanian citizen, entitled together with other employees required by the fulfillment of the object of activity, by the Administration Council.

In the purpose of dissociate some aspect of the current economic practices, we closely surveyed the technological chain of the processing production and also the financial and accounting data obtained from the accounting office of the firm.

Thus we could figure an accurate image of the real situation in order to approximate the usual, current profitability of the unit.

Our survey revealed a very modern shape of the products, under a technically convenient endowing of the process. The sell-prices were fixed at the level of EU, higher than the inner market level, still all the output was sold in an export strategy. At the moment, even if the distribution of the output in the domestic area would be a problem (identified into the distribution price), trading it in the European space is clearly competitive, bringing profit to the business (the complete absorption of the output is secured). The conclusion is: the quality of the products, with its various aspects, is at the highest level, the output is clearly competitive and the salary level is low, compared to other European business. Those low wages compared to other European levels for the same work bring a comparative advantage for the profit of the business, and for the investors. For the foreign investors, this advantage is of the outsourcing nature.

As a general observation, even if this enterprise is of a small to medium size, the planned strategy of the decision makers goes for the expansionist model of a trans-national company, being safe to act in competition with all other economic agents playing in the continental market.

The recommended strategy focuses on the objectives of getting a wider range of goods, of maintaining under control the energetic costs of the whole business, including the transport-distribution costs. On the other hand, in a short time, firms will no longer be able to compete without integrated solution for capturing, generating and using economic data at all points of work and service (supply chain management, data collection, enterprise resource planning, networking, so on) missing elements, or not proper functioning, at the moment of our research.

Succeeding in those targets will secure the European market share earned by the firm.

For the time-being this study is a confirmation for the Romanian economy to align the European market standard, including the

competitiveness and market-forces expressed on the real European market.

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# THE INTEGRATION OF THE ROMANIAN E-SERVICES TECHNOLOGIES IN THE EUROPEAN INFORMATIC SOCIETY



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**Abstract.** *Due to the fact that a big part of the public services is provided/supplied at local or regional level, the main information regarding their condition are available only at the level of the local public administration. The development of the relationship between the institutions of the local public administration and the citizens and also the business environment depends on certain factors, such as the increase of the transparency level for the activities of local authorities. This issue involves the transformation of the general public services in e-Services (electronic services), the free access of all the citizens to the additional infrastructure, based on instruments, applications and technical solutions implemented on the local and central public administration.*

**Keywords:** e-administration; general public services; e-services solutions; durable development; digital signature.

**REL Classification:** 13G; 15D; 17D; 18D



The social, economical and geographic cohesion, as main objective of the European Union, depends on the efficiency of the local and regional public services. For the candidate countries to accelerate their development, it is necessary to develop an ongoing process of implementation of the informatic society. In this context, the structural and cohesion funds can only be applied based on the e-Administration implementation.

The local and central public administration has a main role for the provision of efficient and transparent public services. The link among the informatic policies and strategies as well as other policies, such as the social and development ones, should be approached based on the e-Administration technologies, in order to provide electronic services for the citizens and the economic agents.

Due to the fact that a big part of the public services is provided/supplied at local or regional level, the main information regarding their condition are available only at the level of the local public administration. The development of the relationship between the institutions of the local public administration and the citizens and also the business environment depends on certain factors, such as the increase of the transparency level for the activities of local authorities. This issue involves the transformation of the general public services in e-Services (electronic services), the free access of all the citizens to the additional infrastructure, based on instruments, applications and technical solutions implemented on the local and central public administration.

In our opinion, the e-Services implementation in the public administration will generate the increase of the complexity level for all the approached issues, based on adequate services for each level of the public administration involved. In this context, for the present situation regarding the implementation of e-Services in the Romanian public services, it is necessary to focus on the following priorities:

- a. Acknowledgment of the existing problems regarding the local and regional strategies for e-Administration and also the policies assuring the support for durable development and social cohesion.
- b. Development of portals, information centers and call centers able to ensure free access to the electronic services for all the citizens and the business environment.
- c. Implementation of policies able to increase the use of calculation techniques and the Internet networks in the rural environment.
- d. Development of new public-private partnerships for small and medium enterprises, especially in the rural environment.
- e. Implementation of European services, able to increase the persons and knowledge mobility in the European space.
- f. Implementation of benchmarking systems in the regional e-Administration services.

g. Ensuring the necessary premises for the durable and social development, by implementing policies and strategies in the electronic administration.

h. Training for the staff of the central and local public administration regarding the ICT techniques.

i. Implementation of change management and also certain methods and techniques for leadership and organisational culture in the public administration.

j. Achievement of technologies able to support the e-Services systems.

k. Security of the access to electronic services based on smart cards and electronic signature.

l. Setting-up of economical and mathematics prognosis models able to allow the analysis of the economic indicators for public services.

The achievement of these issues in Romania involves the amendment of the regional policies according to the European regulations and also the orientation of the structural funds to certain domains able to allow the implementation of the informational and communication technology in the central and local public administration. In this context, the main ways of action are the following:

**1. Implementation of the informatic data exchange  
and also assuring the functionality of the regional platforms**

This means that the authorities of the public administration should establish certain data types, methods of consolidation, operation methods on the e-Services platforms, as well as procedures and standards for data setting-up, processing and storage processes. It is also necessary to ensure the data efficiency and the integration in the European platforms. In our opinion, the development of Internet platforms should be able to offer some basic electronic services for the citizens such as: the electronic vote, certain statistics, the payment of local taxes and incomes, information regarding the local investments, cadastral data, information concerning the public services etc.

## **2. Development of software applications specific for the supply of public services**

The public authorities should decide whether they want to implement certain applications open source or their own solutions and must develop costs/benefits analysis regarding their efficiency. Due to the fact that the open source platforms have a great number of personal data, which must be secured against unauthorized access, we recommend the utilisation of certain software solutions dedicated to the public administration such as FLOSS (Free/Libre Open Source Solutions).

The consolidation of the e-Services platform requires the establishment of the following elements:

- Access data: general information such as identification data, information regarding access to the service offered by the platform, the maximum time of conversation between the system and the user, the type of digital signature necessary for identification etc.
- Costs for using the service or the information offered by the platform.
- Ways of payment for the service used by the consumer.
- The service users (physical or legal persons).
- Rights for accessing, editing and observing the content and the functions of the services.
- Structure of the service, including all the characteristics, the objects contained and the existing restrictions.
- Possibilities of adapting the content of the service, in order to implement new functionalities.

## **3. Supplying integrated electronic services**

At the level of the Romanian local public authorities providing electronic services, the information are sent based on individual communication channels, due to the fact that there is no regional or national vision. This issue requires the redefinition of all the administrative procedures and standards in order to offer similar electronic services, even though this process has certain restrictions, such as the organizational culture or technic factors (difficulties in users authentication, lack of digital signature or secured electronic transactions). An unitary e-Services platform at national level represents

an objective able to be achieved only if the re-engineering of the administrative procedures is doubled by the implementation of training programs and bench-marking methodologies. The advantages of the integrated electronic services are the following:

- Increase of the public services efficiency;
- Adapting the existing services according to the customers requirements;
- Implementing new electronic techniques able to ensure the public institutions transparency.

#### **4. Development of e-Administration Competence Centers**

These centers can function on-line (e-learning systems), as regional excellence centers, in order to ensure the e-Specialists training. Use of this training method allows an unitary training environment for the public administration specialists, a better monitoring of their performances and the improvement of the organisational learning process. The following benefits are achieved:

- reduction of the training costs based on elimination of the transport and accommodation expenses for the administrative staff;
- assistance of the the training and learning processes using modern informatic technologies;
- monitoring the training process and the results obtained by the participants;
- reduction of unnecessary time for participating to courses;
- training achievement exactly when it is needed;
- increase of the learning process efficiency based on development of knowledge assimilation;
- possibility to further development of a knowledge management system;
- lack of a maximum number of participants allowed for a single course;
- reduction of the training costs for the training staff;
- increase of self-learning efficiency;
- increase of the organisation knowledge level based on permanent information amendments also indicated to the course participants.

### **5. Implementation of the identity management, the digital signature and the secured transactions**

The issue of the public information security is very important and needs to be approached according to the European Union regulations. In this context, the main ways of action are the following: promoting certificated electronic signatures, developing standards and procedures for the citizens authentication, electronics transactions and use of secured instruments for data stocking, such as the cryptographic devices (smart cards and reader or eToken).

Although the digital signature is partialy already used in the Romanian public administration, for the moment we cannot talk about certain security standards, due to the fact that, in most of the cases, the unqualified digital certificates and the conventional stocking devices (CD or dischette) are still used. The achievent of higher security standards for the e-Services platforms can only be made based on qualified digital certificates, issued by the competent authority, according to the present legal provisions, able to assure the authetification in the system and also the signature on the electronic documents.

### **6. Promoting measures able to assure the increase of the e-Services beneficiaries satisfaction**

The e-Administration services should be doubled by a users motivation system regarding the electronic services. In this context, the main way of action regards the promotion of management systems for the relations with the clients involved in the public administration (Customer Relationship Management).

The elements for each electronic service are processed based on an informatic architecture, which takes over the information regarding the customer, centralizes them in a data warehouse and processes them using 'data mining' techniques, in order to integrate them as e-Services technologies. In this context, the platform should have the following elements:

a. *The unique information center*, as the receiver of the information regarding all the citizens requirements and complaints presented as documents, which are processed in the documents management system.

b. *The contact center* (Call Center/Contact Center/ Help Desk), which is the organisational entity which gives assistance for the citizens requiring information regarding the electronic services. The development of this component generates certain benefits, such as the the reduction of the lost calls based on the intelligent calls distribution, the increase of the citizens satisfaction level based on the increase of the additional value, the monitoring of the beneficiaries satisfaction etc.

c. *The e-CRM component* regards the use of Internet technologies in order to improve the relation with the citizens and the business environment using specific instruments such as the post addresses lists and the personalized e-mail services, the chat services or the interactive dialogues, the forums etc.

Taking into consideration the fact that, once the Romania joined the European Union, the “European citizenship” will determine the increase of the Romanian citizens mobility in the European space, it is necessary to develop new instruments able to allow a fast access to the e-Services platforms, regardless of the user physical coordinates. In this context, a modern European way is the development of e-Services technologies, involving a communication process between the citizen and the public administration based on mobile phones. More than that, there is also the e-Administration mobiles concept, based on which the traditional information centers are replaced by mobile phones. Although a big part of the electronic services can only be provided based on classic e-Administration systems, there are also certain concerns for the identification of new technologies able to face the new European challenges for free citizens access to the public services. Also, the e-Administration and e-Services technologies implementation should promote new concepts, such as e-Participation or e-Democracy, all indicating a new European informational environment, able to satisfy the needs of the European citizens and business environment.

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## THE EUROPEAN STRUCTURAL FUNDS FOR ROMANIA AND OPPORTUNITIES FOR BUCOVINA

■

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**Abstract.** *European Found for Regional Development, European Social Found and Cohesion Found are the European structural funds. They are important resources for the development within the countries of European Union. The EU funds are serving main goals that are oriented to the general economic develop at local, regional and national level. The major priority of the European Structural Funds and of the political cohesion promoted the UE is applying a balanced development and its purpose is decreasing the differences between various areas. The second priority has as purpose to revitalize all the areas with deficient structure (industrial, rural, urban). With its E.U. integration, Romania has the possibility of accessing these founds. A variety of domains can be financed; in Bucovina, part of North-East Region of Romania there are many opportunities to access these founds. Agencies for Regional Development will play a major role because some of the attributions regarding the administration of these founds will be delegated to them.*

**Key words:** *structural funds; EU integration process; Agencies for Regional Development; Operational Plan; Bucovina regional development.*

**REL Classification:** 20 J

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## **Introduction**

The Structural Funds are three financial instruments at countries disposal addressed to specific sectors that have been considered relevant for the social and economic development of European Union and 2 complementary funds. The three main funds are: European Regional Development Fund (ERDF) - finances infrastructure, job-creating investments, local development measures, Small and Medium Enterprises development; European Social Fund (ESF) – oriented to co-finance training and capacity building measures and systems fostering recruitment and employment; Cohesion Fund (CF) – finances infrastructure projects, and 2 complementary funds: Financial Instrument for Fisheries Guidance (FIFG) – it includes measures financing the modernization of fishing industry especially in region where this sector is affected by recession; European Agricultural Guidance and Guarantee Fund (EAGGF) – the guidance section of this Fund finances rural development measures.

### **1. The Structural Funds**

*The European Social Fund (ESF)* contributes to the economic and social cohesion objective set in article 158 of the EC Treaty, by supporting policies and priorities aimed to achieve progress towards full employment, improve quality and productivity at work, and promote social inclusion and cohesion, in line with the guidelines and recommendations under the European Employment Strategy (EES).

In order to achieve this objective, the ESF needs to address three major challenges: addressing the considerable employment disparities, social inequalities, skills gaps and labour shortages in an enlarged Union; an increasing pace of economic and social restructuring due to globalization and the development of the knowledge-based economy; and demographic changes, which have resulted in shrinking and ageing workforce.

The European Social Found shall strengthen economic and social cohesion by supporting Member States' policies aiming to achieve full employment, improve quality and productivity at work and promote social inclusion and the reduction of regional employment disparities. In particular, the ESF shall support action in line with the guidelines and recommendations adopted under the European Employment Strategy. The ESF shall support the priorities of the Community as regards the need to

reinforce social cohesion, strengthen competitiveness and promote environmentally sound economic growth. In particular, it shall take into account the objectives of the Community in the fields of social inclusion, education and training and equality between women and men.

*Scope of assistance*

1. Within the framework of the convergence and the regional competitiveness and employment objectives, the ESF shall support action under the following priorities:

- a) increasing adaptability of workers and enterprises;
- b) enhancing access to employment of job seekers and inactive people, preventing unemployment, prolonging working lives and increasing participation in the labour market of women and migrants;
- c) reinforcing social inclusion of people at a disadvantage and combating discrimination;
- d) mobilizing for reforms in the fields of employment and inclusion, in particular by promoting the development of partnerships and pacts through networking of relevant stakeholders at national, regional and local level.

2. Within the framework of the convergence objective the ESF shall also support action under the following priorities:

- a) Expanding and improving investment in human capital;
- b) Strengthening institutional capacity and the efficiency of public administrations and public services at national, regional and local level to embrace reforms and good governance especially in the economic, employment, social, environmental and judicial fields;

3. In implementing the objectives and priorities, the ESF shall support the promotion and mainstreaming of innovative activities as well as trans-national and inter-regional cooperation in particular through sharing of information, experiences, results and good practices, and through developing complementary approaches and coordinated or joint action.

4. In implementing the social inclusion priority, the financing by the ESF of actions within the scope of the Regulation (EC) may amount to a maximum of 10% of the priority axis concerned.

The Member States and managing authorities shall ensure that the action supported by the ESF is consistent with and underpins the implementation of the European Employment Strategy.

Within operational programs, resources shall be directed towards the most important needs and focus on those policy areas to which ESF support can bring about a significant effect in view of the attainment of

the objectives of the program. To maximize the efficiency of ESF support, operational programs shall take particular account of the regions and localities facing most serious problems, including deprived urban and declining rural and fisheries dependent areas.

*The Cohesion Fund* established by The Regulation no. 1084/2006 of the EU. Council, through which are financed projects in the field of the environment protection and trans European transport network, projects in the field of durable development and also projects which concern the improving of the road and air traffic management, the modernization of the urban transport, the development and modernization of the multimodal transport.

Creation and purpose of the Cohesion Fund:

- A Cohesion Fund (hereinafter: the Fund) is hereby set up for the purpose of strengthening the economic, social and territorial cohesion of the Community in the interests of promoting sustainable development.
- The Fund shall contribute to the financing of programs, which support the objectives set out in the Treaty.
- The Fund is governed by the provisions of Regulation (EC) and by the provisions of this Regulation

Regulation (EC) lays down the general provisions for the functioning of the structural funds and the Cohesion Fund for the programming period 2007-2013. It envisages that the Cohesion Fund contributes to the convergence of less developed Member States and regions through financial participation in the operational programs of this convergence objective.

Under the reform of the implementation system of cohesion policy, Cohesion Fund interventions are integrated into the multi-annual programming of the structural funds, including major projects. The reform was announced in the third cohesion report, which was adopted by the Commission in February 2004. While maintaining the fundamental principles which underlie the value of the policy (multi-annual programming, partnership, evaluation, shared management), this reform provides a balance between an increased strategic component, and a simplification of the implementation system. Simplification notably occurs through the reduction in the number of funds, simplified programming, a clarification of the roles of the Commission and the Member States in terms of financial management and control, and by adapting the implementation modalities to reflect the intensity of the community contribution.

In the field of trans-European transport networks, actions financed by the Cohesion Fund must follow the guidelines for these networks, which were adopted by the Council in revised decision (EC) 1692/96. In the environmental field, the Cohesion Fund contributes to achieving the Union's policy objectives envisaged under article 174 of the treaty.

An extension of the domains of intervention is justified by the accession of new Member States on May 1 2004, all of which are eligible to the Cohesion Fund, and which face new and important financing needs. Thus the Cohesion Fund can also finance actions in support of sustainable development, where these have a clear environmental dimension, such as energy efficiency or renewable energy. Beyond the trans-European transport networks, this also allows for financing of rail, navigable maritime and river waterways, multi-modal transport actions and their inter-operability, road and air traffic management, clean urban transport, and communal transport. This extension of the domain of interventions is in accordance with the corresponding provisions in the treaty, and is in line with the priorities decided by the European Council in Lisbon (March 2000) and Gothenburg (June 2001).

The aim of this regulation is to specify the tasks of the Cohesion Fund, and its specific application, in particular regarding the conditionality of assistance and the fields of intervention of the Fund.

Member States benefiting from the Cohesion Fund must conform to the conditions set out in the treaty regarding convergence programs and those regarding excessive deficits for the Member States participating in economic and monetary union. Assistance under the Cohesion Fund is conditional upon the satisfaction of these conditions. If the Council decides, on the basis of a Commission proposal, that an excessive deficit exists and that the Member State concerned has not taken effective action, the payment will be suspended, effective from January 1 of the following year. The suspension ceases, when the Council decides, on the same basis, that the Member State concerned has taken the measures necessary to allow a return to a situation that is in accordance with the Treaty and with the Council decisions.

*European Regional Development Fund (ERDF)* - The European Union has the capacity of the home market of 27 member states which include over 200 regions. However, not all the Europeans have the same social-economic advantages. The main difference is made by the area where they live – whether it is a prosperous or poor area, a region with future possibilities or in economic decline, an urban or a rural area, on the outskirts of EU or in one of its economic centers. There are significant

disparities between the EU member states and its regions. The ten most dynamic EU regions have a national gross domestic product (GDP) which is five times bigger than that of the last ten EU regions.

In this context, the regional development politics is one of the most important and complex politics of the European Union, status which implies that, having the objective to reduce the economic and social disparities existing among various European regions it can act upon significant development fields.

The main financing domains of the European Fund for Regional Development are:

- Technological research and development, innovation, entrepreneurship, including the reinforcement of the technological development and research abilities and their integration in the European Research Area.
- The informational society, including the development of the electronic communication infrastructure, the improvement of the access and the development of the public on-line services.
- Environment, including investments in water supply and waste management, the treatment of the waste waters, the air quality, the prevention, the control and the fight against drought, the prevention and the integrated control of the pollution.
- The risk prevention, including the development the implementation of the plans for the prevention and fight against the natural and technological risks.
- Touristic activities, including the promotion of the natural values as a potential for the development of a durable tourism
- Investments in culture, including the protection, the promotion and the preservation of the cultural heritage.
- Investments in transport.
- Investments in energy.
- Investments in education, including vocational training.
- Investments in the health and social infrastructure.

European Regional Development Fund (ERDF) has two objectives in view:

- Objective 1 – promoting the development and the structural adjustment of the regions with difficulties. It includes the region corresponding to level two of the Statistical Territorial Units Classified List (STUCL) whose GDP (gross domestic product) per person is inferior to the 75% level of the average amount. It also included the extremely

peripheric regions, the French departments overseas, etc. The European Commission is responsible for the completion of the list of regions to which Objective 1 is applied.

- Objective 2 – favouring the economic and social reconversion of the areas with structural difficulties. The regions to which Objective 2 is applied are zones with social and economic reconversion problems and whose population and surface are significant. They include zones which go through gradual economic and social changes in the industrial and services sectors, rural zones in decline, urban zones in difficulty and zones depending on fishing, which are in a crisis situation.

The main objective of the European Fund for Regional Development is to ensure financial assistance in order to reduce the main gaps between the development levels of various regions. The admissible measures for the ERDF intervention are adjusted to the objectives and priorities of the cohesion politics, such as:

- Investments in infrastructure. The interventions through this fund are focused on increasing the economic potential, development, structural adjustment, creating and making the places of work last in the regions selected for Objective 1. It also includes investments which contribute to the creation and the development of the trans-European networks in the transport, telecommunications and energy sectors, taking into account the necessity of interconnecting the central regions of the community with those which have structural disadvantages, fact which derives from their insular position, lack of access ways and their peripheric location. In the regions or zones mentioned by Objectives 1 and 2, ERDF can help by financing the investments in the infrastructure field of the declining industrial areas, the renovation of the disadvantaged urban zones and by improving and integrating the rural and fishing-centred areas. In the same time, the activities which create places of work and those which aim at connecting the communication infrastructures and not only, are also financed

- The development of the internal potential by means of local development initiatives and by covering the labour power as well as by supporting the activities of the small and medium enterprises through incentives offered in order to create new places of work (excepting the measures financed by the European Social Fund).

In other words, ERDF particularly supports the following sectors :

- the productive environment, especially for developing the competitiveness and durable investments of the small and medium

companies, and for increasing the capacity of attracting the regions through the potential of their infrastructure.

- technological research and development in order to favour the development of new technologies.
- the development of tourism and investments in the cultural patrimony, included its protection and that of the natural one, with the condition to create new places of work.
- the environment protection and amelioration, taking into account the precaution principle and the preventive actions which support the economic development, the complete and efficient use of the energy and the development of the regenerating energy sources
- sustaining the fair chances for men and women by creating enterprises and service infrastructure which can facilitate the balance between the family life and professional one.

## **2. The mechanism of applying for Structural Funds**

When the Operational Programmes are finalized, the ministries have the obligation to present "the complementary programme" to the European Commission and to the MFP, the former will be itemized. Then the applicant's guide, which is similar to those in the Phare programmes, will be elaborated. Here the request will be stated: how it should be prepared, what kinds of documents are necessary.

If the *Phare programmes* and the before-adhesion programmes have been dedicated to the preparation for the European rules, the structural and cohesion funds aim to reduce the difference of development on the social and economical level between the regions and between the states which are members of the EU.

Up to now, through the Phare programmes, the beneficiaries have been accustomed to proportional allowing or implementing. There has been an advance, then other intermediary payments, so the beneficiary has enough funds to develop the activities which have been proposed in the project. Now the beneficiary will receive a payment in advance, and after that on his own expense, he will develop activities, payments, and after that with the invoices he will require a discount.

The rules are extremely tough. We have got the famous rule "n+2": the projects must be contracted, finalized, implemented and the payments must be done within 2 years from the granting of the financing. If a segment of the highway is not finished in time, there could be blockages,



even trials, and the Romanians, the authorities in charge, will have to finance what's left from the state budget, that is instead of using European funds, we will pay from our budget.

There will be opportunities especially for the private branch. The implementation of these funds is done with the contribution of the private branch. None of the projects will be implemented by the state, everything will be done based on auctions. The private branch will have a decisive contribution, with all his components: production small and medium enterprises, service suppliers, goods and equipment suppliers, non profit organizations, as service and expertise suppliers.

*The experience of the states which are already integrated.* We can learn from the recent problems which the New Member States of the EU. faced. Both the beneficiaries and the institutions have had troubles with EU funds. Some of the projects have been of a doubtful quality and not very well achieved. The institutions have had problems with assessing the projects and with establishing the final list. This is a process that has to be managed within a very short period of time. A lot of difficulties concerning signing the contracts and doing the advance payments have been identified.

What Romania has done up to now to prevent these problems from happening? A special programme for institutions assistance has been introduced. The communitarian laws are changing. Every year there is a new rule, a new decision. The deadlines for the institutions to adapt are very short. The inertia is great. To back up the institutions to get prepared, we need financial support.

Checking the management of the funds will be a real adventure for the institutions in Romania. About 1% of the troublesome projects is considered normal. In order not to "surpass" this percentage, a complex system has been invested system, which will hopefully work even here. In all the member states there are problems with developing the projects, and there will surely be in Romania. Our only concern must be maintaining them under control. A management of the structural funds indicates between 0,5 and 1%, the percentage of troublesome projects. It's a rate which is accepted in the majority of the member states.

There are three levels of financial ckeck over which are done in different institutions. The highest level will be found between MFP and the Audit Authority, an institution which was established near the Count Court, independently. It has been created with this special aim and also to achieve the closing of the programmes – the certification that the payments have been done according to the financing contract and the

other documents which were at the basis of the achievement of the projects. Without realizing, a final beneficiary will have between 3 and 5 institutions which will check the correctness of the using of the funds.

*The following aspects will be monitored:* the registration of the documents, of the invoices, the way in which the institutions manage the projects, everything will be monitored by the authorities. There will be an unique computer system dedicated to the management of these structural funds, which is already finalized. This one will connect MFP directly to the European Commission. All the authorities will be able to follow all the troubles or possible frauds so that the troublesome beneficiary will be easy to identify.

*The attributions of the Regional Development Agencies concerning the management of the Regional Operational Programme (POR)*

The Regional Development Agencies, as Intermediary Organs, will take some attributions concerning the management of the funds through the Regional Operational Programme, at the regional level, and The Ministry of European Integration, as a management authority, will assure the monitoring and the check of the commissioned attributions, with the aim of implementing the Programme.

The Frame Agreement represents the document closed between The Ministry of European Integration (MIE), as a Management Authority for the Regional Operational Programme, and the Agency for Regional Development as an Intermediary Organ, which establishes the general frame for the implementation of the Regional Operational Programme 2007-2013 in Romania, at the regional level.

This Agreement presents the responsibilities and the attributions of the Management Authority and of the Intermediary Organs for the implementation of the Regional Operational Programme and it will be closed for a period of 10 years, which will also cover the period of implementation of the programme, until its official closing.

A number of attributions will be assigned by the regional level, which will have a major impact on absorbing the structural funds in the developing regions of Romania. Among the main attributions assigned are: informing, publicity, help-desk (informing and support centre for applicants and beneficiaries); the development of the project portfolio; the participation in the project assessment and selection process, signing the contracts with the beneficiaries; monitoring and checking the implementation of the projects which are financed through POR 2007-2013.

*The Operational Programmes (PO)* represent a detailed elaboration of the investments which are to be done in different fields. These must be prepared, finalized by a ministry or a public institution responsible with the elaboration of many policies. The programmes and the institutions which are responsible: for human resources, the responsible ministry is MMSSF. The Operational Regional Programme, coordinated by MIE will be implemented by ADR. The programme which is dedicated to the transports, implemented by the specialized ministry, in cooperation with other institutions such as: CFR, The national Agency of Roads, etc. Another regional programme is dedicated to the protection of the environment and is managed by the Environment Ministry. One of the most important programmes, of Competitivity, will be managed by The Education Ministry. There will be another programme dedicated to technical assistance, institutional preparation managed by MFP (the Ministry of public Finance). This one will be necessary due to the difficulties which already have been pointed out in other member states. For the same reason there will be another programme dedicated to the state institutions, to help the function the same way the similar institutions from the member states do.

### **3. The mechanism of developing post-adherence programs in Romania and opportunities for Bucovina**

The Structural and Cohesion Funds will bring important investments every year after January, 1<sup>st</sup>, 2007, along with numerous risks and difficulties for the private and the public institutions. The European programs, which start in 2007, contain essential differences compared to the pre-adherence programs. The project can “turn against you” in case the expenses are not eligible and it is not completed in due time.

The domains and the activities financed by the Structural Funds vary from investments in production to social services. Conditions: well designed projects and possessing enough money for co-financing. A potential beneficiary has to identify what he needs in order to develop his company, all this before the launching of the programs. This year, everyone who is involved in a private activity, small and medium companies, has to settle his development priorities for 2007 and, mainly, the direction of the requested financing. There will be a lot of opportunities for all the companies and all the fields. Despite this, it will be impossible to develop 3-4 projects in the same time. This is a

consequence of their complexity and their necessary private contribution, of minimum 20-30%.

Bucovina is included in the north-east development region of Romania, considered to be one of the most underdeveloped regions, and so it will receive quite large funds, according to the EU politics in order to eliminate the disparities among regions. Known also by its traditional name of Moldavia, the North East Region of Romania is an area in which history, culture and traditions complement the attractive surroundings. This area has long been seen as a romantic and unknown outpost of Europe. Soon it will form part of the eastern border of the European Union and NATO. The low costs and skilled labor make North East Romania one of the most cost-effective investment locations in Europe.

Among the fields which will be able to receive financing we can mention: business development, the development of small and medium enterprises, support for start-up, the development of management and marketing techniques. Another important aspect which hasn't been found up to now in any of the Phare programmes: investments in the production infrastructure. Specific to Bucovina, there could be projects for manufacturing wood, the small farms and investments in the field of dairy. The development of human resources could be financed: professional training, preparation and reorientation of the unemployed, social inclusion, support for professional training. Last but not least, the protection of the environment, touristic projects and the development of services.

A very important segment in this zone is tourism. It can contribute in a significant manner to the development of the region. The main attraction points are: churches and monasteries, which famous for their paintings, unique buildings in the world, a rich flora and fauna with unique reservations in Europe, natural factors and mineral resources recommended in complex health treatments, the variety of ecological products, which are very cheap, traditional cuisine with specific dishes and the inhabitants' hospitality characteristic to the Latin ethnic people, the variety of folklore and traditions, inherited from the ancestors which are very well kept and practised in every day life.

The favourable context for the development of tourism is created by the rapid re-launching of the tourism which has a special place in the development the national economy, the development and the promotion of touristic programmes, backing up some projects which point out the value of touristic objectives, and cultural-spiritual events, the variety of the touristic offer, the promotion of some miniprogrammes which

fulfill the demands of the market for active holidays (mountainbike, hang glider, rafting, equestrian tourism, etc.)

### Conclusion

The Structural and Cohesion Funds: Development Fund, the European Social Fund and the Cohesion Fund establish the framework for the action of the Structural Funds and the Cohesion Fund. It fixes, in particular, the objectives, the principles and the rules concerning partnership, programming, evaluation and management. These funds are financial instruments through which the European Union acts to cut out the economical and social differences between regions, with the aim of achieving an economical and a social cohesion. They will bring some billions of Euro every year in our country beginning with 2007, lest they should be used properly. There are a lot of opportunities but there will also be problems, as there were in other state which adhered to the Union previously. Bucovina, as a part of the North East Region, can get funds in different fields beginning with investments for production and ending with tourism.

Romania institutions are hardly working in order to prioritize the direction of strategic development. Part of attributions regarding the administration of European funds will be delegated to the regional level at la Regional Development Agencies.

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# IMPACT OF ROMANIA'S INTEGRATION INTO EUROPEAN UNION ON THE CAPITAL MARKET IN ROMANIA



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**Abstract:** *The present paper intends to study the development of the stock exchange market in Romania stating as marks, two simple things, namely: the progress of the stock exchange market before and after January 1, 2007, and also the progress of the stock exchange markets in the neighboring states after 2004. For this study, the mathematical calculus of the stock exchange index variation and the stock exchange capitalization is followed. The results have a direct link with the macroeconomic situation and the small investor's understanding level related to the stock exchange phenomenon. Outside of analysis, the answer for an unprecedented development of the stock exchange market in Romania is found by means of the investment tool diversification and the increase of the investor number, the collocation-money make money being cultivated.*

**Key words:** stock exchange; market; stock exchange evolution; stock exchange capitalization.

**REL Classification:** 11B, 20B



The integration of Romania in the European Union is a result of the intercessions made by the Romanian society after 1989. The most sensitive barometer of the economic speculative or in substance changes is represented by the stock exchange market. Analyzing the stock exchange progress is equal with studying the main stock exchange index variations. Such as the progress of a share rate in stock exchange gives the image of the market value and the issuing company performance, also, the stock exchange index shows the performance of the whole stock exchange

market. The stock exchange index is the average price of the all securities or the most representative securities, only, which are quoted on exchange. The most used calculus methods are simple arithmetic mean and weighted arithmetic mean.

The progress of the indexes follows, with a bigger or smaller accuracy level, the fluctuations of the economic activity and the evolution of the internal and worldwide social and political frame, more or less favorable. In fact, we can say that both the security prices and the market index show rather *the investor's perception* concerning the performances of the quoted enterprises and their *trust* in the future of the listed companies.

In Europe, the build of an united trans-frontier market by some states, namely Belgium, Netherlands, France and Portugal under the name *Euronext* must be reminded. This united market is made in order to offer new investment opportunities for the fund holders, being a very fluid market, with low prices. Within the family of the FTSEEurofirst indexes are: FTSEEurofirst 80, which represents the performance of the most representative companies in European Union, and FTSEEurofirst 100, where are also included renowned companies of Great Britain.

Coming back to the analysis of the capital market depending on the expansion of the European Union to East, the years 2004 and 2005 were very good years for the most capital markets of South-East Europe. In these conditions, the capital market of Romania had an excellent period standing out the other considered markets.

If in 2004, the stock exchange in Romania registered a twice rate increase, in 2005 the trend was carried on and also the differences towards the other markets.

#### **The stock exchange evolution in South-East Europe in 2005**

*Table 1*

Country	Index	Monthly average variation of 2005 year
Romania		
BVE	BET	+29,34%
BER	RASDAQ-C	+18,16%
Bulgary	SOFIX	+14,32%
Czech Rep.	PXSO	+6,22%
Hungary	BUX	+5,49%
Slovakia	SAX	+1,18%
Poland	WIG20	-3,78%

**Source:** data processed on the basis of the information drawn upon Financial Market periodical.



The stock exchange of Romania was a pleasant surprise exceeding the expectations regarding the rate progress. If in 2004 a daily average flow of 100 billions ROL was considered as a good one, in 2005 was imposed a minimum boundary of 200 billions ROL.

If in 2004 the most increases were manifested at the issuers from the second category, in 2005 the companies belonging to the first echelon of the stock exchange registered significant increases.

The increases registered in 2004 were relatively surprising if we are thinking to the progress from the last two years. So, after an excellent year 2002, from all points of view, when a generalized increase of the shares and a appreciation of the BET index of 119,8% were registered, followed on a year 2003, which was a disappointment, with stable progresses and a increase of index of 30,9%, only. In these conditions there were apprehensions that stock exchange (or, at least, the shares listed on exchange in that moment) riched its potential and in the absence of some new issuers and new tools, the share prices will be limited.

The year 2004 was gone against this assumption: the BET index increased with 101,2%, the BET-C index (determined on the basis of the prices of the all shares listed on exchange) with 103,8%, and the BET-FI index (determined on the basis of the prices of the SIF shares) with 115,5%. The flows of the currency market led to even better performances of the stock exchange expressed in currency than that expressed in lei. In the year 2005, the BET increase decreased to half of the increase value in 2004 and in 2006 this decrease was maintained against 2005. The stock exchange performances decreased the market, which became stable; also it was registered a rate inflation decrease corroborated with a decrease of the average interest rate on market.

The year 2006 was a relatively good year from the point of view of the investments on the capital market, but the performances were generally under expectations. The BET index registered an increase of 22% in 2006. The performance stands robust against the level of the bank interests on deposits, being about three times bigger than this. However, 22% represents the lowest yearly increase of the index from the last six years (the yearly average value of BET during 2001-2005 is of 68%); the composite stock exchange index, BET-C, registered an increase of 28,49% in 2006. The transaction value with shares listed on BVB increased with 27% only, in 2006, against an increase of 223% in 2005 and one of 140% in 2004.

In the range of the positive events, we record the completion of the consolidation between BVB and Rasdaq, the introduction of the transactions in margin for the spot market (shares), the successfully deployment of two public emissions of spectacular debentures (those of the

World Bank and those of the Romanian Commercial Bank), the foundation of the central depositary, and the successfully listing after the completion of an initial public offer for Transelectrica shares, the first issuer listed on exchange from the utility field.

As minuses for the stock exchange activity, we mention the non-approval of the consolidation between BVB and BMFMS, the ending without success of one from those three initial public offers launched in this year (CCC Blue Telecom), the small number of new listings, the unbeginning of the public security transaction even in 2006 and the non-introduction of the sales in absence.

Romania of the last years, a country with a functional market economy, with an inflation in decrease, with a permanent recessive trend of the interest rate, with the appearance of the privately administrated pension funds, with the revival of the mutual fund market, is the proper place for the development of a potent capital market. In fact, the permanent increase of the prices related to the securities quoted on exchange, as well as of the volumes reveal the interest paid to Stock Exchange Bucharest by the investors and the financial circles.

Regarding the markets of Central Europe, in our study starting from the daily, weekly, monthly, yearly analysis of the main stock exchange indexes from Central European markets, for the period 1997-2006, the results are listed below.

#### **The main stock exchange indexes from Central European markets**

*Table 2*

	<b>DAX</b>	<b>BUX</b>	<b>PX-D</b>	<b>WING20</b>
<b>Country</b>	<b>Germany</b>	<b>Hungary</b>	<b>Czech</b>	<b>Poland</b>
Average value	0,017	0,054	0,021	0,008
Standard deviation	1,800	1,959	1,742	1,890
No. of observations	1888	1861	1714	1863

**Source:** Data processed in the base EUROSTAT.

One can see that the stock exchange market with the best profitability was the market of Hungary because of the progresses from 2004, when it was recorded the best period of the Hungarian stock exchange market history. The main companies with the best progresses on exchange were the Petroleum Company MOL, the company OTP and the chemical combine Barsodchem. But the risk proper to the Hungarian market is the highest.

The progress of the worldwide capital markets determined essential changes in the level of development and the dynamics of markets from the Central and East-Europe. The index progress (and, in fact, of the Romanian capital market) was correlated to a great extent with that of the indexes from the other important markets existing in area (PX – Czech Republic, WIG – Poland, BUX – Hungary).

The progress of the stock exchange indexes (WIG in Poland, PX in Czech Republic and BUX in Hungary) comparatively with the progress of the Stock Exchange Bucharest is reflected below:

#### The main stock exchange indexes on East European market

Table 3

	2000	2001	2002	2003	2004	2005	2006
<b>Poland</b>	-1.3%	-22.0%	3.2%	44.9%	27.9%	33.7%	24.3%
<b>Czech R.</b>	-2.3%	-17.5%	16.8%	43.1%	56.6%	42.7%	-1.8%
<b>Hungary</b>	-12.8%	-9.2%	9.4%	20.3%	57.2%	41.0%	5.6%
<b>Average</b>	-5.5%	-16.2%	9.8%	36.1%	47.2%	39.1%	9.4%

Source: www.Kmarket.ro

#### The stock exchange evolution indexes of the Stock Exchange Bucharest

Table 4

BVB	2000	2001	2002	2003	2004	2005	2006
<b>Capitalization</b>	0.4	1.2	2.7	3.7	11.9	18.1	26.8
<b>Var. %</b>	-	195.3%	121.2%	36.5%	221.8%	52.3%	47.2%
<b>Trans. Value</b>	0.1	0.1	0.2	0.3	0.7	2.7	3.0
<b>Var. %</b>	-	51.9%	61.9%	41.4%	147.6%	257.2%	10.9%
<b>% BET</b>	21.5%	38.6%	119.8%	30.9%	101.0%	50.9%	28.8%

Source:www.kmarket.ro

The correlation between markets becomes more and more strongly, as our capital market is maturing and the foreign institutional investors begin to understand that this market belongs to Central and East Europe space, where the markets from Czech Republic, Hungary and Poland were dominant till now (the last countries also begin to make a more and more significantly correlation with markets more developed).

The causes of these correlations have on the base the similar strategies of the strong institutional investors from the markets belonging to

a certain area. So, although the value of purchasing of shares listed on BVB made by the non-resident investors represented only 30% from the total value of the purchasing (percent which is relatively constant for more years), these finished the year with a net position of purchasing (more purchasing than sales), while the local investors finished 2006 with a net position of sale. So, although a smaller weight in transactions is registered by the non-resident investors, as a rule, making investments on longer terms, they launched for many times the important trends of purchase or sale in market; the local investors generally aim speculative investments on shorter terms, and follow an ascendancy trend.

According to a study accomplished by Răzvan Pasol, the effects of the European integration from May 2004 on the markets from Poland, Hungary and Czech Republic were the positive ones, the progress of the three stock exchange capitalization developed as follows (in billions USD):

**The stock exchange capitalization on the market of Poland, Czech Republic and Hungary**

*Table 5*

	2000	2001	2002	2003	2004	2005	2006
<b>Poland</b>	29.9	25.2	27.1	36.0	58.7	95.4	116.9
<b>Czech Rep.</b>	11.1	8.9	14.6	22.8	43.7	54.1	63.6
<b>Hungary</b>	12.0	9.9	10.8	15.5	17.6	23.0	21.5
<b>Average %</b>	-	-17.7%	26.9%	44.2%	56.1%	39.0%	11.2%

Source: [www.Kmarket.ro](http://www.Kmarket.ro)

One can see that the most important progress of the stock exchange capitalization is properly to the period from 2004 year for Czech Republic, to the period from 2005 for Poland and Hungary. These data mean otherwise the different approaches regarding the development of the capital market by attraction of foreign investments and by encouragement of the indigene capital. The market from Poland felt well these influences because of a coherent politics regarding the use of the private capital invested in private pension funds for stock exchange placements and the attraction of foreign capital and foreign company for quotation on Stock Exchange Warsaw.

For the investment analysis on the capital market from Romania, the profitability progress was studied for the following activity fields:

- 1) Financial field
- 2) Industrial field
- 3) Chemical field

- 4) Building field
- 5) Metallurgical field
- 6) Machine - tool and repair field
- 7) Electric and electronic field
- 8) Pharmaceutical field
- 9) Food products
- 10) Navigation field.

The calculated profitabilities in the period 2002-2006 within these fields shown that the biggest profitability of the financial investments is achieved in the financial field with a maximum value of 20,2% in 2005 and a variation between 14,4% and 20,2%; the companies that were selected in the portfolio content being four securities, namely: BRD, TLV, SIF1 and BCC.

Depending on the profitability registered during the period 2002-2006, it follows the field of machine-tools and repairs, with a maximum profitability value of 18,3% registered in 2004 and values included between 14,5% and 18,3%. The companies selected in portfolio made of 6 securities were: TBM, RBR, NEPT, MEF, CMP, SNBB.

On the third place as importance of the profitabilities registered is the pharmaceutical field with a maximum profitability value of 18,1% in the year 2005 and values of the profitabilities ranging between 14,1% and 18,1%. The companies selected in portfolio made of four securities were: SCD, ATB, BIOF, TER.

Forwards, other portfolios were also selected depending on the field of which the component securities belong, namely:

➤ The building field a field in expansion with a maximum profitability of 17,2% in 2003 and values that vary between 15,5% and 17,2%. The companies selected in portfolio were: IMP, SANE, ELPS, the portfolio being made of 4 securities.

➤ The navigation field with a maximum financial profitability of 15,3% in 2003 and a variation range between 11,5% and 15,3%. The companies selected in portfolio were: ROMT, SOCP, CMVX, SNO, the portfolio being made of 4 securities.

➤ The metallurgical field, with a maximum financial profitability of 14,7% in the year 2005 and a variation range between 12% and 14,7%. The companies selected in portfolio made of 4 securities, being: ALP, ALT, DUCL, COS.

➤ The electric and electronic field, with a maximum financial profitability of 12,8% and a variation range between 11,6% and 12,8%. The companies selected in portfolio made of 4 securities, being: IPRU, EPT, ELZY, ELJ.

➤ The field of the food products that registered a maximum profitability of 12,5% in 2003 with a variation range between 10,8% and 12,5%. The companies selected in portfolio made of 4 securities were: UARG, PRAE, VEL, BRM.

➤ The chemical field, with a maximum profitability of 11,4% in the year 2005 and a variation of the profitability between 7% and 11,4%. The companies selected in portfolio made of 8 securities were: PCL, AZO, CRB, AMO, STZ, RLS, ARFE, OLT.

➤ The industrial field, with a maximum profitability of 7,4% and a variation range between 2,9% and 7,4%. The companies selected in portfolio made of 6 securities were: SNP, RRC, PTR, COTE, OIL, PTS

The analysis on fields enables to conclude that in Romania the transactions are very concentrated in the conditions where the first ten companies listed generated 85% of stock exchange capitalization comparatively with an average value of 60% in the other states newly integrated in European Union. Other element that shows the concentration grade of the market is that near 90% from the total volume of the transactions in 2005 was achieved with the shares of eight companies only, respectively those five SIF-s, BRD, Transilvania Bank and Petrom.

The elements of transparency and corporatist governing are insufficient yet developed: there is no law related to the stockholder in minority, for important operations at Stock Exchange, the derived tools were not implemented, the little investor is forwards slightly present on market. Beginning from the aphorism stating that on a sound market the little investor is "a small fish in a large pool", the our expectations are in the development of the capital market in Romania, which has a position behind the countries entered after 2004 in European Union.

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# THE REGULATION OF THE ENERGY MARKET IN ROMANIA

■

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**Abstract.** *Delivery public utility services at the level of the demand and with the respect of an appropriate quality standard represents a fundamental element of the lasting development and of the poverty reduction. In order to resolve these problems the state intervenes in the economy, using as instruments the reform and the regulation. The established rules are usually conceived as barriers at the entering or the exit of the market, specifications for the licenses issue or for the fees establishment, monitoring of the prices or of the salaries etc. The regulation is one of the most convenient forms of policy, because it doesn't impose new taxes or governmental expenses. It is even more attractive in a period of budgetary austerity.*

**Key words:** *regulation; public utility; energy market; regulation authority; quality standards.*

**REL Classification:** 10J

■

## **1. The need of the existence of regulations techniques in the implied domain**

For a consumer to take the right decision concerning the utility of the good and to be able to appropriately evaluate the consequences of his choice he must have access to enough information. In the contemporary period, consumers deal with an informational inflation, in which the technical and specialty information prevails by much his capacity of

understanding, respectively his capacity to evaluate the consequences of his decision. This is a disputed problem of the contemporary market.

Solving the market's specific problems is usually done with the state's intervention in the affected domains, using as instruments the reform and the regulation. During the last two decades most of the reforms and regulations have been specific to the services and public utilities industry.

Services and public utilities have an important weight in the economy of the countries in the European Union, representing the basis of the processing and producing industry. The technologies' development, the important increase of the demand generated the need of reform and reorganization in these sectors that have been generally projected and realized as vertically integrated entities.

The OECD studies indicate three types of regulation:

➤ Economic regulation

This form of regulation is pointed to the prices, profits or monopolies market entry regulations. The state tends to avoid the potential abuses generated by the monopoly positions on the market and to create an efficient substitute for a more aggressive competitive policy which would lead to the scale economies sacrifice.

➤ Social regulation

It is focused on the modifications of the production processes, of their quality, its purpose being the protection of public interest, such as health, public security etc. The social regulation's economic effects are usually secondary but they might be substantial.

➤ Administrative regulation

Governments collect information and interfere with the individual economic decisions. These decisions can have a significant impact on the private sector's performances.

In the specialty theory and practise, several methods of regulation have been identified, in accordance with the domain's complexity, the imposed demands and the decisions that will take place after the regulation. In this context, the most well known regulation methods are:

√ *The regulation through public property*

The public property was, through time, the main method of economic regulation in Europe. Without analysing the multitude of objective and ideological justifications, the general view was that the public property will always increase the government's possibility to regulate the economy and protect the public interest. In these conditions, public companies would lead the economic structure directly towards the production decisions and indirectly towards the price decisions.



During the last 40 years governments have tried to impose the performances of the public property regulation by:

- The settlement of clearer objectives for the public companies;
- The increase of the public companies managers' responsibilities;
- The enlargement of the access to information.

There are of course serious criticisms to this regulation system:

- The influence of the public companies' managers by politicians;
- Public monopolies;
- Ambiguous responsibilities of the public managers;
- The weak coordination between the public companies;
- The lack of real control of the parliament on the public companies.

√ *The regulation by independent regulation agencies*

This method of regulation is relatively recent in Europe and it appeared in the same time with the privatization of the utilities' industry, as with that of other industries that affect the public interest. These sectors make the subject of rules developed and imposed by specialized agencies (in Romania-authorities respectively) or commissions.

The general rule is the planning and the initial implementation of a regulation environment before the real beginning of the privatization process. The regulations must respect the industry's structure and the nature of the regulation instruments in the economy. Each country in Europe established its own regulation style and its own methods, taking into account its economic, political and institutional capacities for the domain.

These agencies usually have the statute of independent authorities, meaning that they can operate outside the hierarchical control lines or the strict supervision of the central departments of the governments. The main asset of this regulation method consists of: the specialization of the regulation offices, the independence (approximate) to the political domain. There are also a lot of criticisms to the system:

- The influence of the regulation authorities by the regulation firms;
- Anti-competitive regulations;
- Vague objectives;
- The weak coordination between the regulation authorities;
- The insufficient political responsibility of the independent regulation authorities.

Indifferently to the type of agency, responsibilities must be clearly outlined. Although it is important for the regulative organisms to have the flexibility to develop their own regulative style, attention has to be paid to

the development of a correct structure of the regulative organisms' responsibility. This is why clear rules are needed concerning the responsibility and the communication between the government, the regulative authorities and the juridical system. In contemporary Romania we can talk about a perfectible attempt of the public services domain regulation.

√ *The firm's inherent regulation*

The regulation can also be realized by tasking with this problem some departments owned by the economic agent, situation that gives to the firm the responsibilities in the regulations' domain. This method of regulation has a long tradition in the air transport industry. But lately we are witnesses of the development of this type of regulation in many other domains, as management conceives the standardization of its activities as a way of recognition of the quality of its work by the consumer.

The inherent regulation gives a number of advantages compared with the other methods of regulation:

- It offers a higher specialization and technical knowledge degree in the relevant domains;
- The regulations are less formal;
- The administrative costs are supported by the company and not by the tax payers;
- The regulations have a higher efficiency in comparison with those emitted directly by the government.

Most of the firms that adopt the inherent method of regulation didn't perfect a control system of the regulation's respect, and naturally don't have an appropriate penalization system for the aberrations from the regulated system. The firm that adopts still by its own initiative the internationally valid regulations system will benefit from a competitive advantage in the sector.

In the public domain there are an impressive number of institutions which have a regulative and supervision role in several domains. All the institutions with such attributes have however registered failures, as the system and the legislation didn't help to the regulations' implementation.

Inherent regulation can be useful but it can't replace the one made by the independent regulative authorities.

√ *The utilities sectors regulation*

The economic regulation (as distinctive type of social regulation) usually covers economy sectors like electricity, natural gas, communications, transport, agriculture, banking sector etc. The established regulations usually take the form of barriers at the entrance or exit of the market, licenses delivery or tariffs establishment norms, prices'

or salaries' control etc. still, in the last two decades, several economic regulations have been reformed or even cancelled, when theoreticians, political decision factors and public became convinced that they impose costs on the society's general wealth: they make the markets less competitive, discourage economic efficiency and reduce the general wealth of the consumers.

The regulative activity imposes at the same time *direct costs* for the respect of the norms, costs which are usually supported by the business sector (supplementary bureaucracy, equipments, lawyers' expenses etc.), but also indirect costs, relative to its effects on work and its productivity. Regulation is one of the most convenient methods to make politics, as it doesn't imply new governmental taxes or expenses. It becomes even more attractive in a budgetary austerity period.

In reality, regulation acts as a hidden tax, as its costs, the direct and indirect ones, are passed to the consumers, employees and employers, making them practically impossible to follow and evaluate.

On the other hand, regulation is necessary, especially in the recently liberalized sectors, where the introduction of the competitiveness doesn't only depend on the elimination of legal barriers at the entrance on the market.

That last one can also oppose to the competitiveness's increase either by the refuse to grant the access to the essential facilities that it holds, or by their supply but with a much reduced quality or at too high prices. As a result, regulator's action to prevent such behaviours will lead to the appearance of *benefits* for the entire society. The regulator's actions efficiency depends on his capacity to deal with the problem of the asymmetry of information and of the offer of necessary stimulants, as on the credibility of his actions.

## 2. The regulation of the energy market in Romania

Supplying public utility services at the level of the demand and with the respect of an appropriate quality standard represents a fundamental element of lasting development and of the reduction of poverty. This influences the economy's development level, the leaving level, the health, the education and the creation of new jobs. In the same time, the supply of public utilities services is one of the entry data for the three pillars of lasting development: social equity, economic growth and environment protection.

In Romania the unitary institutional juridical frame, the objectives, the competences, the attributions and the specific instruments useful to

the foundation, organization, administration, financing, exploitation, monitoring and control of the public utilities communitarian services functioning is created by *The communitarian public utilities services law*, no. 51/2006. The law's text defines the public utilities service as: "*the total amount of general public interest ant utility, developed at the communes', cities' or district's level under the management, the coordination and the responsibility of the local public administration authorities, with the purpose of the satisfaction of the local communities' demands, by which are assured the following utilities:*

- a) *water supply;*
- b) *canalization and used waters' purification;*
- c) *collecting, canalization and eviction of pluvial waters;*
- d) *thermal energy production, transportation, distribution and supply in a centralized system;*
- e) *localities' sanitation;*
- f) *public lightning;*
- g) *the administration of the public and private domain of the administrative-territorial units, and of other similar;*
- h) *local public transport."*

The text of the law also mentions that public utilities services are part of the general interest public services and they have the following particularities:

- a) *they have an economic-social character;*
- b) *they respond to demands and necessities of public interest and utility;*
- c) *they have a technical-hereditary character;*
- d) *they have a permanent character and a continuous functioning regime;*
- e) *their functioning regime might have monopole features;*
- f) *they suppose the existence of an appropriate technical-hereditary infrastructure;*
- g) *the covered area has local dimensions: communal, municipal or district;*
- h) *they are founded, organized and coordinated by the local public administration authorities;*
- i) *they are organized on economic and efficiency principles;*
- j) *they can be supplied/performed by operators who are organized and function either on the grounds of the public law regulations, or on the basis of the private law regulations;*
- k) *the recovery of the running or investment costs is made by prices, tariffs or special taxes<sup>(1)</sup>.*

In the fourth section of the mentioned law the public utilities services regulative authorities are specified. So the competent regulative authority for the following public utilities:

- a) water supply;
- b) canalization and used waters' purification;
- c) collecting, canalization and eviction of pluvial waters;
- d) thermal energy production, transportation, distribution and supply in a centralized system;
- e) localities' sanitation;
- f) public lightning;
- g) the administration of the public and private domain of the administrative-territorial units.

Is *The national authority of regulation for public services of communal administration (ANRSC)*, which, according to the text of the law, delivers licenses, elaborates methodologies and frame-regulations for the public utilities services domain in its regulation area and for the market of these services and monitors the respect and implementation manner of the applicable legislation to these services.

The activity of production of thermal energy in cogeneration is submitted, according to the stipulations of the Law no. 51/2006, to the licensing, regulation and control of *The national agency of energy regulation (ANRE)*, whose competences and attributions are regulated by the Electrical energy law no. 318/2003 and by the legal stipulations regarding the thermal energy supply public service.

In October 2006, the economy Minister proposed that the energy regulators be supervised by a new authority, the Energy Markets Supervision and Monitoring Authority, which would function in parallel with the regulative authorities of the specific energy markets and verify if the decision that they take are the right ones. The economy and commerce Minister, Codrut Seres, declared to the NewsIn Agency on the 19<sup>th</sup> of October 2006: "*we are talking about a monitoring authority who would make impact studies, prepare reports about the prices and the necessary energy quantities, reports about the deficiencies of the market and even participate to the domain's public policies elaboration*" and he specified that for the foundation of this authority he had the support of the United States Aid for International Development (UNAID). The representatives of the Energetic Policy Department of the Economy and Commerce Ministry (MEC) declared to the same press agency that the proposed authority will be founded and administrated by technocrats, who will monitor including the activity of the three regulative authorities for the electrical energy, thermal and natural gas energy markets. "*The new*

*authority will make public information and will send information to the Parliament, but also to the Government about the way the regulative authorities' decisions influence the energy market,"* said the quoted sources. The MEC responsible have also said that the Executive takes into account the possibility of grouping in a single institution ANRGN, ANRSC, ARCE (The Romanian Agency for Energy Preservation) and ANRE.

Presently, the energy market is regulated by the three institutions presented above: The National Authority for Energy Regulation, National Authority for Natural Gas Regulation and National Authority for Communal Administration Public Services Administration.

### **3. Attributions of the National Authority for Energy Regulation (ANRE)**

The energy sector is a strategically important sector; it constitutes one of the decisive factors for the social and economic evolution of the country. Because the operating mode of this sector has an impact on all the other domains of activity, the Romanian state has founded through the Electrical Energy Law no. 318/2003 the National Authority for Energy Regulation – ANRE, as an autonomic public institution of national interest, with juridical personality, that functions under the direct coordination of the Prime-minister and on the basis of its own organization and operating regulation, approved by the Decision of the government no. 1816/2004, modified and completed by the Governmental Decision no. 1847/2005.

According to the Law no. 318/2003, ANRE *elaborates, establishes and follows the application of the ensemble of national obligatory regulations, necessary to the functioning of the energy market and sector, in efficiency, competitiveness, transparency and consumers' protection conditions*. The financing of the ANRE's activity is made entirely of extra-budgetary revenues, obtained from the tariffs for the delivery of licenses, authorisations and attestations, and also from contributions of the economic agents or international organisms, according to the legal stipulations concerning public finances. The mission of the institution is to create and apply the regulations system necessary to the functioning of the electrical energy and thermal energy produced in cogeneration market and sector in efficiency, competitiveness, transparency and consumers' protection conditions. In the development of its mission, ANRE tends to integrate the regulation act to the actions of other regulative authorities and to harmonize with the objectives and priorities of the Government.

On the grounds of the Urgent Ordinance of the Government no. 11/2004 concerning the establishment of reorganisation measures inside the central public administration approved with modifications and completions by the Law no. 228/2004, with the ulterior modifications and completions, ANRE finds itself under the direct coordination of the Prime-Minister.

In the fulfilment of its attributions, ANRE collaborates with the Competitiveness Council, with the National Authority for the Consumers' Protection, with ministries and other central or local public administration authorities, with the electrical energy consumers' associations, with specialized economic agents who offer services in this sector, with professional associations in the thermal and electrical energy domain, with patronal and union associations.

The ANRE activity for 2005 had the following coordinates:

- Continuation of the process of delivery, modification or redraw of licenses and foundation authorisations;
- The attestation of economic agents who plan, execute, verify and exploit electrical installations in the electro-energetic system and the authorisation of electricians who project, execute and verify electrical installations;
- Completion of the regulation frame with new commercial regulations;
- Thermal and electrical energy prices and tariffs adjustments in order to cover the justified costs. ANRE has revised the calculation methodologies for the regulated prices and tariffs for the electrical energy and connected services;
- The completion of the technical regulations necessary;
- Coordination of the inspection, guiding and control activities, especially oriented to the guidance of economic agents concerning the application of the regulations emitted;
- Petitions and pre-contractual disagreements' resolution<sup>(2)</sup>.

The ANRE activity takes place on the grounds of the annual working program, called *The Regulations Program* and renewed according to the legislative evolutions, organization modifications of economic agents in the thermal and electrical energy sector that impose the realisation of new regulations. ANRE emits and administrates the following documents:

- ✓ *Authorisations, permits and licenses* for economic agents in the thermal and electrical energy sector;

- ✓ Calculation *methodologies* for the prices and tariffs, for the solution of pre-contractual disagreements, for follow and control;
- ✓ *Regulated prices and tariffs* for the captive consumers;
- ✓ *Frame-contracts* for the sale, the acquisition, the transport and the distribution of electrical energy among economic agents in the sector, as those for the electrical energy supply to the final consumers;
- ✓ *Regulations, norms and instructions* regarding the national electro-energetic system and the electrical energy market functioning<sup>(3)</sup>.

#### Orders and decisions emitted during the period 1999 – 2005

Table 1

Nr. crt.	Orders and decisions concerning	year							Total
		1999	2000	2001	2002	2003	2004	2005	
1	Licenses, permits and authorizations for activities developed in the electrical & thermal energy sectors	7	156	262	243	157*	102	200*	1227
2	Economic agents attestation	-	-	-	-	-	136	819	955
3	Commercial relations, regulation	19	50	19	28	23	26	33	198
4	The qualification for priority electrical energy production	-	-	-	-	-	-	41	41
5	Resolution of the pre contractual disagreements	-	32	83	38	28	14	41	236
6	Prices and tariffs for the activities developed within the	4	509	821	567	199	141	219	2460



Nr. crt.	Orders and decisions concerning	year							Total
		1999	2000	2001	2002	2003	2004	2005	
	sector, calculation methodology								
7	Technical regulations	10	11	7	4	10	10	9	61
8	Other regulations concerning the thermal and electrical energy sector and the intern organization of ANRE	44	121	92	104	113	181	277	932
9	<b>Total</b>	<b>84</b>	<b>879</b>	<b>1284</b>	<b>984</b>	<b>530</b>	<b>610</b>	<b>1639</b>	<b>6010</b>

Source: Annual report of ANRE 2005, p. 7, [www.anre.ro](http://www.anre.ro)

In order to reach the objective of the quality insurance for the thermal and electrical energy suppliers' activity ANRE has elaborated the *Performance standard for thermal and electrical energy supply services*. These standards regulate the performance indicators of the guarantee of the thermal and electrical energy supply services, taking into account:

- The permanent adaptation to the consumer's demand;
- The guarantee of the services' continuity;
- The quality guarantee;
- The exclusion of any kind of discrimination regarding the consumers' connection and service.

The content of the standards is annually revised by ANRE and adapted to the concrete conditions, respectively to the legislative frame.

The context of the adhesion of Romania to the European Union makes the ANRE efforts tend to the implementation of regulations and existing legislative frame with the purpose of the competitiveness' increase on the electrical energy market. Starting with July 2005 the opening degree of the electrical energy market became of 83,5%. All the electrical energy consumers, households excepted, are free to choose their electrical energy supplier. The complete liberalization of the electrical energy market planned for the 1<sup>st</sup> of July 2007 is going to also allow to the households the free selection of the supplier.

#### **4. Attributions of the National Authority for Natural Gas Regulation (ANRGN)**

Romania has one of the largest natural gas markets in Central Europe. In the same time, our country was the first to use natural gas for industry as a result of the application of the governmental policies oriented to the elimination of the dependence on importation. The application of these policies led to an intensive exploitation of the internal production. Out of the total amount of natural gas consumption of 17,6 billion m<sup>3</sup> for the year 2005, the internal natural gas production represented almost 12,4 billion m<sup>3</sup>. The difference was represented by imports from the Russian Federation. This quantity satisfied entirely the internal market.

In 2005 Romania registered a number of 2,41 million natural gas consumers.

The reform process initialised in our country at the beginning of the '90s was oriented on three main directions:

- Prices and exterior commerce liberalization;
- State companies' privatization;
- Financial-banking sector's development.

In order to guarantee an organized frame concerning the equitability and indiscriminative natural gas allocation from internal and import production, the Industry and Resources Ministry, by the *Order no. 85/02.04.2001 for equitability and indiscriminative natural gas allocation from internal and import production* founded the Market Operator, within the National Dispatcher for Natural Gas Bucharest Transportation TRANSGAZ SA Medias.

By the Government's Ordinance no. 41/2000, approved by the Law no. 791/2001, with the ulterior modifications and completions, the ANRGN was founded in February 2000, public institution under the direct coordination of the Prime-Minister. After the National Authority for Natural Gas Regulation's foundation, the competences of the National Agency for Mineral Resources referring to natural gas have been reduced to the concession of the exploitation of the blocs.

Due to the dynamics of the profound transformations in the natural gas sector and market configuration, case in which the general regulation frame – the Government's Ordinance no. 60/2000 referring to the regulation of the natural gas sector activities, approved by the Law no.

463/2001 and the Government's Ordinance no. 41/2000 referring to the foundation, the organization and the functioning of the ANRGN, approved by the Law no. 791/2001 – remained behind these evolutions and the circumstances determined the initiation of an unitary regulation that led to the abrogation of the two ordinances.

As a result, on the 28<sup>th</sup> of July 2004, the Gas law no. 351/2004, published in the Official Monitor of Romania, Part I, no. 679 was approved by the Romanian Parliament. Structured on 15 Chapters and 120 articles, the law mainly regulates:

- The natural gas policy;
- The organization, functioning, role and attributions of the regulator authority;
- Authorisations, licenses and attestation in the natural gas sector;
- The public service and consumer's protection obligations;
- The market, the prices and tariffs in the natural gas domain.

The Gas law gives a new valence to the ANRGN. In this new legislative context, the authority's mission consists in the elaboration, application and monitoring of the observance of the national obligatory regulations in the domain, necessary to the running of the natural gas market and sector with efficiency, competitiveness, safety, transparency, indiscriminate treatment of the natural gas market's participants and consumer's and environment's protection conditions.

In order to accelerate the integration of the European regulations to the internal legislation and to redefine the public authorities' attributions, aiming to the adaptation to the new forms of collaboration with the EU structures, the modification and completion, in urgency regime, of the Gas law no. 351/2004, by the Urgent Ordinance no. 116/2005 became mandatory. That one was adopted by the Romanian Parliament through the Law no. 288/2005 published in the OM no. 922/17 October 2005. Also, the regulation frame of the natural gas sector was improved by the modification of the constitution of the Consultative Council and its extension to 11 members, by the increase of the number of representatives of the consumers. By this, the guarantee of a more appropriate balance was pursued in view of the harmonization of the sector's economic agents' interests with those of the natural gas consumers. The new constitution of the ANRGN's Consultative Council was approved by the decision of the president of the National Authority for Natural Gas Regulations no. 486/01.11.2005.

Since 2001, ANRGN began the prices' and tariffs' system reform<sup>(4)</sup> in the natural gas sector. This reform was meant to implement a new system which would reflect the effective costs of the natural gas supply and to stimulate the investment in the sector, in the context of the liberalization of the internal market and of the elimination of the crossed subventions between different categories of consumers. The measures were accompanied by the institution of a grant program of financial aid to the population with reduced income and using natural gas for the home's heating (Urgent Ordinance no. 91/2005, OM no. 643/20.07.2005, modified afterwards by the Urgent Ordinance no. 184/2005). At the end of 2005, the government adopted the decision referring to the correction of the aid's level for the home's heating with natural gas (GD no. 1666).

Starting with the 1<sup>st</sup> of August 2001 it was established the initial degree of opening of the natural gas internal market, representing 10% of the total consumption of the year 2000. In consequence to this opening and according to the eligible consumers' accreditation regulation, the Centralised List of eligible consumers was approved. So, for 2005, the opening degree of the natural gas market was established to 50%, against only 25% in 2002, within the limits of a natural gas quantity of 9,150 billion m<sup>3</sup>. The eligible consumers were 130 in 2005, out of who 75 already existed in 2004 and were reaccredited according to the modifications brought to the accreditation regulation, and 55 new eligible consumers were added. The number of eligible consumers in 2005 was 217% higher than in 2002.

For the year 2006, by the GD no. 1397/10 November 2005, published in the Official Monitor no. 1036/22.11.2005, the opening degree of the natural gas internal market was established at a 65% level of the total internal consumption. That was possible given the fact that the civil society and the consumers' representatives considered opportune the acceleration of the natural gas market opening process.

Due to the registered progress, it was decided that starting with the 1<sup>st</sup> of July 2006 the opening degree of the market will be of 75%.

The next steps in the Romanian natural gas market liberalization are those stipulated within the negotiations for Romania's adhesion to the European Union, respectively:

- 100% for the non-domestic consumers, starting with the 1<sup>st</sup> of January 2007;
- 100% for all the consumers, starting with the 1<sup>st</sup> of July 2007.

Also, measures will be taken for the perfection of the secondary legislation of the market's functioning, of the rules concerning the natural gas trans-frontier exchanges and for the increase of the exploitation and supply security.

At the same time, since the 1<sup>st</sup> of July 2006, consumers and suppliers who have decided to close natural gas transportation contracts for interruptible services benefit from a constitution reduction for the capacity's reservation of 5,5% against the present level.

ANRGN pays special attention to the undertaken activities in the context of Romania's adhesion to the European Union. So, ANRGN is implied in the respect of the stipulations of the Position Complementary Document, referring to the 14<sup>th</sup> Chapter – Energy (CONF - RO 06-04) of the European Union.

Also the ANRGN has developed and implemented a quality management system in accordance with the International Standard ISO 9001:2000. The approach is useful for obtaining the supplied services beneficiary satisfaction and trust in the role and vision of the authority. In this context the institution has been elaborated a standard that regulates the performance indicators for the accomplishment of the natural gas supply activity on the wholesale market, by the natural gas supply license owners in relation with other natural gas suppliers or eligible costumers .

ANRGN has actively participated within the countries, working groups, conferences and seminars organized by the CEER (Council of Europe Energy Regulators). This organism reunites the regulator authorities in the EU and in the European Economic Area (EEA) , ERGEG (European Regulators Group for Electricity and Gas), ERRA (Energy Regulators Regional Association). It is a voluntary organism of the regulators authorities for energy of Central and Eastern Europe, EASEE-gas (European Association for the Streamlining of Energy Exchange-gas), ENGVA (European Natural Gas Vehicle Association) and GIE (Gas Infrastructure Europe). At the profound changes in the natural gas sector, ANRGN was an active participant, the authority contributing to the creation of the legislative frame in accordance with the European Directives in the energy market. ANRGN led a regulation policy by which it tried to guarantee the competitiveness and transparency of business in natural gas domain, the in discriminatory treatment of the market participants, the consumers and environments protection.

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**Notes:**

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- <sup>(1)</sup> Law no. 51/2006 concerning the public utilities communitarian services, published in the MO, part I, no. 254, on 21.03.2006, 1<sup>st</sup> art.  
<sup>(2)</sup> Annual ANRE report 2005, p. 7  
<sup>(3)</sup> Annual information report of ANRE 2005, [www.anre.ro](http://www.anre.ro)  
<sup>(4)</sup> Monitoring report for the internal natural gas market of ANRGN August 2006, [www.anrgn.ro](http://www.anrgn.ro)

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## EU REGIONAL POLICY – CONVERGENCE AND ECONOMIC GROWTH?



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**Abstract.** *Besides its primary scope of supporting the lagging behind areas, the EU regional policy represents also the flexible companion of other EU objectives and policies: it was reshaped many times in order to meet EU challenges and realities, either these were linked to enlargement or to the organization competitiveness on the world stage. Also, the new architecture of this policy, putting together the concepts of convergence and competitiveness, stands for a great challenge concerning its successful implementation and impact.*

**Key words:** regional policy; structural funds; convergence; Lisbon Agenda; economic growth.

**REL Classification:** 20 J



Even if the European Union represents one of the most prosperous areas in the world, the development disparities between the Member States and between the 255 regions (including Romania and Bulgaria) within its borders measured by the GDP/capita register significant high values<sup>(1)</sup>.

The socio-economic differences and the development imbalances between the territories of the European Union are the main factors that underpin the community intervention through the regional policy.

The Cohesion Policy at EU level aims at reducing the disparities between the most and less developed regions, usually quantified in terms of GDP/capita. The objective of this policy is “to support the actions which are meant to contribute at the reducing of the economic, social and

territorial disparities within EU (CEC 2001)". The manner of achieving this goal is the concentration of resources in the areas "lagging behind". Most of these funds are allocated to the regions that have a GDP/capita less than 75% of the EU average<sup>(2)</sup>.

The functioning principle of the cohesion policy is based on shared competences between the European Union, the member states and the regions. The distribution method, on which this policy is based, concentrates more than 2/3 out of the available resources.

The concept of regional policy derives from the broader concept of socio-economic cohesion and defines at EU level a set of planned and promoted measures of the local and central public administration, in partnership with diverse actors (private, public, volunteers), with the scope to ensure a sustainable and dynamic economic growth, through efficient capitalization of local and regional potential, for a better quality of life.

## 1. CRONOLOGICAL EVOLUTIONS

### Rome Treaty

In Rome Treaty was mentioned for the first time the concept of socio-economic cohesion, but since the member states at that moment were relatively homogeneous from economic point of view – the development disparities between regions, except for the south of Italy, were not too large – this concept was not afforded too much attention and redistributive mechanisms were not foreseen at the moment.

The profile of a regional policy is shaped beginning with 1972 – 1975, in parallel with the accession of three new member states: Great Britain, Denmark and Ireland, when also becomes necessary to be formulated a concrete mechanism to diminish the development differences inside the union (ERDF, 1975).

The socio-economic cohesion became objective only in 1986 (after the accession of Greece, Spain and Portugal – the poorest members of the organization) through the European Unique Act, representing the central pillar of the development policy. The regional policy was financed through ERDF, ESF and EFAOG – Guarantee, on the basis of rules and regulations formulated by the European Commission.



### **The 1988 Reform**

The framework of the reform consisted in 5 Regulations of the Council and one Implementing Regulation of the Commission, which came into force on the 1<sup>st</sup> of January 1989 (following to be renegotiating for each programming period). This new approach proposed a new regional policy based on multiannual integrated programmes implemented with the participation of many levels: community, national, regional. The logic of this approach proposed the elaboration of a framework programme – the Community Support Framework, which should be undertaken at another level and implemented in regions by multi-funded operational programmes. Also, there were introduced 4 principles: concentration<sup>(3)</sup>, programming<sup>(4)</sup>, additionality<sup>(5)</sup> and partnership<sup>(6)</sup>.

The reform doubled the volume of structural funds allocated through the community budget, from 6,3 mld. Ecu in 1987 to 14,1 mld. In 1993.

### **The 1994<sup>(7)</sup> Reform**

Following the increasing of disparities in parallel with the increasing of number of member states, the total volume of Structural Funds was increased 3 times, from around 43,8 billion Ecu between 1988-1993 to over 141 billion Ecu between 1994 – 1999 (values calculated for 1992 prices)<sup>(8)</sup>. The main modifications regarding the applying mechanisms of Structural Funds envisaged the eligibility criteria and the administrative procedures.

### **The 1999 Reform**

The financial package determined by the extension to East of the EU was included in the document entitled Agenda 2000 (Agenda 2000 for a stronger and larger EU). According to this document, EU wanted that the enlargement to take place without a major reform of its financial system.

According to Agenda 2000, *the monitoring, evaluation and control principle* is the new element of the Structural Funds Reform in 1999. In these conditions, the member states have administrative attributions and

have obligations in nominating *the national authority<sup>(9)</sup> corresponding to each programme financed under the Structural Funds and also the Monitoring Committees.*

*The objectives* of the regional policy for this programming period are:

- *Objective 1 (territorial)* – for the less developed regions, the funds are focused on the basic infrastructure and stimulating the economic investments.
- *Objective 2 (territorial)* – supports the socio-economic recovery in industrial, rural and fishing – dependent areas, which encounter structural difficulties.
- *Objective 3 (thematic)* – targets the modernization of the training and promoting the employment systems. The measures financed under Objective 3 covers the whole union, except for the Objective 1 regions, in which case the training and employment measures are included within the reducing the disparities between the regions programmes.

## **2. The new architecture of EU regional policy**

European Union enlargement to 25 member states and now to 27 represents an unique situation for the economic competitiveness and internal cohesion of the structure. The enlargement emphasized the economic development inequalities and provoked a geographic variation through the East of disparities aggravating more the labour force market: socio-economic inequalities will double, and the GDP average will decrease with 12,5.

The main objective of regulation amendment is the necessity of redrafting the cohesion policy by taking into consideration the Lisbon Strategy. Mainly, the proposal for the new Community Strategic Guidelines aims to focus the actions within three main themes, accordingly to Lisbon Agenda priorities: *making the member states and the regions attractive economic areas for investments, promotion innovation, creation of more and better jobs.*

The main causes for the cohesion policy reform are the enlargement of the European Union and the implementation of the Lisbon Strategy.

a) *Enlargement*

▪ Commission considers that the European Union enlargement from 15 to 27 states represent an unique chalange for the competitiveness and internal cohesion of the EU.

▪ The rate of the income per capita between the wealthiest and the poorest regions from EU will increase from 2,6 in EU 15 to 4,4 in EU-25 and 6 in EU-27, the GDP average will decrease with 12,5%.

▪ In UE-27, over 1/3 of the population will have un income per capita less than 90% of the Community average (the current eligibility threshold for the Cohesion Fund) in comparison with 1/6 at present.

▪ The EU-27 countries can be classified in three groups: the most prosperous countries having a GDP per capita over the Community average formed by the actual member states excepting Greece, Spain and Portugal; the intermediary group formed by the Greece, Spain, Portugal, Cyprus, Malta, Slovenia and Czech Republic having a GDP per capita of 80% of the Community average; the third group which includes also Romania, has a GDP per capita of 40% of the EU-27 average.

b) *Lisbon Strategy*<sup>(10)</sup>

▪ In spite of the Lisbon strategy, the economic growth of the EU decelerates since 2001, parallel with the increase of the unemployment rate in some areas of the Union.

▪ Commission considers that the cohesion policy has an important contribution at achieving the Lisbon objectives, by reducing the intracomunitarian disparities and ensuring the participation of all regions and social groups at the general economic development of the Union. For these reasons, the cohesion policy must be considered as an integrated part of the Lisbon Strategy.

▪ The European Commission proposed a programming system with the following stages:

– Defining by the European Council of the *Community Strategic Guidelines-CSG*

– Development of the national strategies by the member states (*National Strategic Reference Framework-NSRF*) in accordance with the EU strategy

– The operational programmes drawing-up by the member states.

The European Commission proposes the focusing of the cohesion policy on a limited number of priorities for ensuring a growing effect and a significant added value to the community structural actions.

The new proposed objectives are:

a) *Objective 1 – regional development convergence*: 2/3 of the fund will support the regions where GDP per capita is less than 75% of the Community average, practically the new member states; 1/3 of the allocation will sustain temporarily the regions from old member states that faces the statistical effect of the enlargement (regions that exceed the 75% eligibility rate because of statistical decrease by accession of new member states with a GDP per capita less than 75% of the Community average reported at EU-15)

b) *Objective 2 - regional competitiveness and employment*: aims to sustain the Lisbon and Gothenburg strategies by anticipating and promoting economic changes in industrial, urban and rural areas, in order to increase their competitiveness and attractiveness, as well as by supporting the employment.

c) *Objective 3 – European territorial cooperation (balanced territorial development)* with the following components: crossborder cooperation, transnational cooperation and inter-regional cooperation. The aim is to identify common solution for common problems, by collaboration between the competent authorities of neighborhood entities in areas as development of urban, rural, costal areas, strengthening the economic relations and involving within this network the small and medium enterprises.

For the new convergence objective, established for the period 2007-2013, are eligible 100 regions representing more than 35% of the EU-27 population; the rest of 155 regions with a population representing almost 61% of the EU population are eligible for the regional competitiveness and employment objective.

The main amendment proposed by the Commission envisages the philosophy for using these funds. In order to adapt to the new cohesion policy approach, characterized by concentrate interventions on a limited number of priorities/ objectives, adaptability to the territorial specificities, coordination with the other communitary policies, the European Commission proposes a reformed implementation system, with the following principles:

a) *Financial assistance principles*

There was agreed to be applied the partnership, proportionality and additionality principles, as well as empowered equality between men and

women principle. The partnership must be organized accordingly to the institutional framework of each state.

*A more pronounced strategic approach (based on the EU priorities)*

The European Commission<sup>(11)</sup> proposed to define the EU priorities through a strategic document adopted by the EU Council (Community Strategic Guidelines). These priorities will be transposed by each member state within the National Strategic Reference Framework negotiated with the European Commission and implemented through the operational programmes by taking into account the financial and thematic concentration principal. The financial resources are concentrated in areas with major needs. The thematic concentration focuses on the Lisbon and Goteburg priorities.

*c) Decentralized and territorial approach with more responsibilities for the member states, regions and towns*

Each region can benefit by and implement a programme. Territorial specificities are taken into consideration by integrating the urban dimension, by giving attention to areas with natural disadvantages (islands, mountain areas, rural areas with low density of the population), to northern areas and ultraperipheral regions.

*d) Simplifying the management methods*

- The use of three financial instruments (Cohesion Fund, European Regional Development Fund, European Social Fund) and the financing of each programme from one fund (one fund = one programme);

- The integration of the projects financed under the Cohesion Fund in multi-annual programming documents, applying the same rules as for the structural funds;

- The programming and the financial management done by priorities and not by measures as in the actual programming period;

- The use of the national eligibility rules instead of the Community ones.

### **3. Synergies and conflicts: regional policy and Lisbon agenda**

The Lisbon Agenda does not make the inventory of new objectives, but of objectives and priorities defined likewise or easily

reformulated within the content of Community policies and bring them forward to act upon them.

The global objective of Lisbon Agenda focuses the European Union and the member states on competitiveness, increasing growth rate, high employment rate, in the framework of a balanced economy, both socially and ecological. The logic of this strategy is to direct the investments to economic growth, while the concerns for the regional and local levels have a minor role.

The structural funds contribute significantly to the implementation of Lisbon Agenda, taking into consideration that in many regions more than 2/3 of the financial allocation through these funds supports activities directly connected to the Lisbon Agenda objectives, while in the regions with a lower share the main reason is the necessity of investments in basic infrastructure, revealing particularly financing needs for the less prosperous regions of the European Union.

There are fundamental points of congruence among the general objective of Lisbon Agenda and the objectives of the Structural Funds – economic growth being a common objective, as well as growing employment rate and reducing unemployment. Moreover the both approaches recognize that development and economic growth should not be obtained by damaging cost of the environment.

Numerously specific objectives reveal, also, complementarities and congruencies: all the priority themes involving allocation funds for various investments categories (IT infrastructure, research/development, human capital, business environment development, social inclusion) are very well reflected in the expenditure headings of the Structural Funds (there are measures having more than 50% activities financed from Structural Funds with direct impact on the Lisbon objectives).

There are also major differences between the Lisbon Agenda and Structural Funds, the strongest one between economic growth and economic and social cohesion.

Unlike the Lisbon Agenda defined as a general framework for the whole European Union aiming at increasing the European economy performance, the Structural Funds have as objective the cohesion, offering an important spatial dimension of the economic growth objective in the specific areas of the Union: member states, regions, deprived areas with low density of the population, peripheral location or structural economic deficiencies. Furthermore, the spatial dimension is not so

important for the Lisbon Strategy, defined as a strategy for the whole Union and not for regions, state or peripheral territories within the Union.

Another important difference is the objectives drawing-up: while the Agenda is composed by a combination of general and operational objectives, the philosophy of the structural funds proposes general objectives at the level of the Union, allowing in the same time a decentralized process for strategic implementation and prioritization. Therefore, the Lisbon Agenda can be defined as a uniform agenda with a top-down approach, even if it involves decentralized voluntary implementation, while the structural funds have a governmental system better defined with a bottom-up regional approach within the programming process.

The objective of regional cohesion is essential for the Structural Funds, but not also for Lisbon Agenda. Thus, if is intended to raise the synergies and complementarities between the two types of instruments, this approach must respects the cohesion principal.

Last but not least, there are important differences of prioritization the investments fields: traditionally, the structural funds sustain priory the investments in basic physical infrastructure, offering possibilities also for developing other fields (cultural heritage, specific local manufacturing) which neither are very relevant nor comprised in the Lisbon Agenda.

The main question is how the Structural Fund can contribute in the most efficient way at fulfilling the objectives of Lisbon Agenda.

By investing in human and physic capital, the structural funds can generate positive results and commitment effects. By reducing regional disparities, the sustaining of regional development can generate growth positive effects using different methods. The growing unemployment rates in specific regions are associated with a low labor productivity that involves inefficient governmental costs. The development disparities between regions can generate economic costs in more and more areas. Solving of these problems can stimulate the economic growth.

For this reason, there are favorable arguments for the structural funds contribution both at growth and development at regional level that lead to aggregate economic growth at the Member State level or at European Union.

Meanwhile, there are also empiric proves for the interchange economic growth – regional economic inequities: in the first phases of recovering disparities process, the economic growth tends to locate in

development areas, involving thus the increasing of economic disparities. Even if there are taking into consideration these analytical premises, increasing the investments effect through a growing efficiency of the Structural Funds interventions can diminish the difference between the economic growth and regional disparities.

From the economic theory perspective, an absolute applicability of the investments type financed through Structural Funds at Lisbon priorities is at least debatable, considering that not all specific priorities of intervention represents an optimum for each region of the European Union, but are applied to the European Union as a whole. Moreover the growing effects determined by investments in different fields depend with a large extend also by the context of the investment made.

Thus, there is the risk of affecting the growth, convergence and cohesion, if according to the Lisbon Agenda, the Structural Fund supports, within the less developed regions of the UE (within the convergence objective), IT infrastructure, informational society, research and development despite the physical infrastructure.

In order to respond the Lisbon challenges, the European Commission proposed, for the 2007 – 2013 programming period, a specific objective for competitiveness and employment focusing on three thematic areas: innovation, environment and risks neutralization, accessibility.

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**Notes:**

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<sup>(1)</sup> According to the forth progress report for cohesion, presented by the European Commission on 12.06.2006, the relativ rapid growth of the 13 cohesion countries, compared to EU-15 (3,6% per year, compared with an average of 2,2% of the EU-15, between 1995 - 2005), reflects a certain level of convergence in terms of incomes. However, the size of income disparities shows that are necessary many years for the organization, as a whole, to register significant decreasing of the development disparities.

<sup>(2)</sup> The level of GDP reflects regional realities quite different: in the new member states (including Romania and Bulgaria, which contain 12 of the poorest EU regions) there are few regions in which GDP/capita is less than 25% of the EU average in 2002.



<sup>(3)</sup> The *concentration* is the basic principle of the structural reform in 1988, with the scope to concentrate the regional policy tools where there are the most difficult problems regarding regions disadvantages.

<sup>(4)</sup> *Programming principle* refers to the multiannual development plans preparing, which is realized on the basis of the decisions made in partnership with the Member State and through a series of successive phases, being finalized with task assuming by the private or public bodies.

<sup>(5)</sup> *Additionality*, being one of the oldest principles of the regional policy, stipulates the fact that the EU sources complete and not substitute the financial resources of the Member State which receives the non-repayable assistance in order to reduce/eliminate the development disparities.

<sup>(6)</sup> The partnership principle is closely linked to the subsidiarity principle, which ensures a degree of independence for the inferior level authorities compared to the superior level ones. This principle imposes a strong collaboration between the Commission and the national, regional and local authorities, socio-economic partners and other abilitated bodies, especially through their involvement in all phases – from the drawing up and approval of the development plans to their implementation and monitorization.

<sup>(7)</sup> This reform took place in the perspective of the 1995 enlargement, when other 3 countries will become EU Member States: Austria, Finlandia, Suedia.

<sup>(8)</sup> Gabriela Drăgan – the European Union between federalism and intergovernance. EU common policies, electronic version courses, [www.ase.ro](http://www.ase.ro)

<sup>(9)</sup> The National Authority has attributions in the implementing, correct administration and efficacy of the programme and the Monitoring Committees complete the authorities activities through the control of quality and efficiency in implementing structural measures. Also, there are very important the principle of decentralization the decision making process, from central level to the regional communities and the principle of cofinancing – the financial contribution of different actors implied in the elaboration of the regional development programmes and projects.

<sup>(10)</sup> The Strategy adopted at Lisbon, as well as the whole process following the European Council from March 2000, established the global strategy with the objective of making the European Union to become in ten years “the most competitive and dynamic economy based on knowledge from the world until 2010, with more and better jobs and a

high social cohesion". While the initial Lisbon process continued to be developed (adding within the European Councils aspects concerning environment protection, sustainable development, entrepreneurial development or competitiveness), the main problem remains the integration of the well-established dimensions of the European policies.

<sup>(11)</sup> In the former programming period, for the member states there was a set of strict rules regarding the programming documents necessary for accessing the structural funds: National Development Plan, a general programme negotiated with and approved by the Commission – Community Support Framework, Operational Programme and Programme Complement. For the new programming period there are used two types of documents National Strategic Reference Framework (having a political character) and operational programmes. All the other documents used so far in the negotiation process are in the responsibility of the member states.

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# THE INSTITUTIONAL RECONSTRUCTION AND THE FUNCTIONALITY OF THE MACROECONOMIC SYSTEM

■

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**Abstract.** *The text is analyzing the requirements of the institutional reconstruction for the running of the macroeconomic system. A number of concepts concerning the macroeconomic structure, the social validation, structural economy, output and input within the macroeconomic process, the effect of the fiscal pressure on the labor factor income etc., are duly defined. Here we have also a special attention is paid to those unfit macroeconomic policies, specific to certain periods of time.*

**Key words:** *system; macroeconomics; structure; institutional frame; destructureation;; real output; fiscal pressure; macroeconomic policy; gross domestic product; market.*

■

**REL Classification:** 13B, 13I, 18G

The understanding of the level and sense of the evolution registered by the macro-economic and macro-social indicators of our country in the after 1989 period of time supposes to approach the answer to the question: how appears the economy of the Romanian society during this period of transition?

At this question, the academician Emilian Dobrescu responds with the syntagma “*weakly institutionally structured system*”. By institutional framework, the authors understands three essential components, being in interaction between themselves, namely:

- “*the main elements*” that compose it (the property rights, the rules of the human interaction, the extent and the modalities of the public authorities interventions in the economic life);
- “*the grade of specification*” of these components (a clear and non-contradictory definition or, on the contrary, an ambiguous definition);
- “*the social validation*” (the formal and informal institutions making them operational ones).

With regard to the possible combinations formed between these elements, the literature of specialty identifies two types of economic systems: the first is an economic system “of a high expected stability”, named “*structured economy*” and the second economic system “*with a relatively low expected stability*” considered “*weakly structured economy*”.

Without underestimating the theoretical-methodological importance of a such delimitation, we think that this reflects only partially the complexity of a reality in full transformation, from the countries today developed economically to the non-developed countries, to those being in transition from the Marxist socialist to another system of organizing and operation of the economic-social life, that of the market economy.

The denomination of *structured economy*, given to the first economic system, could have, as term of comparison, *the non-structured economy*.

In our opinion, *a institutionally structured economy means that economic system having clear rules concerning the rights of property, the institutions guaranteeing these rights and the control mechanisms for the risks emerging from the evolution of the natural-human and social phenomena, at the scale of the collectivities society organized.*

Within this type of economy, we can identify *an institutionally structured economy, according to the rules of the democratic game and an institutionally structured economy in accordance with the rules of a non-democratic game.* In both cases, the economic system is institutionally structured, the fundamental difference being represented by the economic and social-human performance provided by these two systems, especially by that of the *liberal capitalism and centralized*

*Marxist socialism.* Each of these two types of economic systems can have various level of stability, following an institutional structure more or less well structured, with consequences for the economic and social-human performances, the control of the risks and incertitude implied naturally by the evolution and the interactions of the natural environment and those of the environment created by man.

*The weakly institutionally structured economy can be an economy in course of institutional formation,* such as the economies of the countries in transition from the system of centralized Marxist system to the system of liberal capitalism of the market economy, or economies unable to position themselves into a certain institutional structure, these being in a permanent state of transition towards something unclear, difficult to be anticipated and defined, and with negative effects for the life's quality.

In the case of an economy weakly institutionally structured, being in a natural course of behavioral positioning, the evolution can be identified as a transition from childhood to the youth to the maturity of the active life of a human individual, when gradually are formed and developed not only the biological components of the human life, but also his natural-human and social mechanisms and behaviors, as parts of a whole that exists and accomplishes only on the basis of the social communion sentiment.

Generally, an economy being on the counter-sense of the evolution concerning the economic and social life is non-adequately institutionally structured, its components, their interactions generate negative externalities of each part against the whole, but, also, the movement of the whole against the way the interdependencies of the evolution are produced.

Considering that the transition from the economy of the Marxist socialism to the economy of the liberal capitalism is a process that is, after the fall of the Iron curtain and the fall of the Berlin Wall, on the normal sense of the evolution for the economic and social-human life, naturally, and that provides the birth and the affirmation of the institutional structure meant to provide the balance of the progress, means the unfolding, at the same time, of the *old institutional deconstruction with the new institutional reconstruction*, where the behaviors of sense are interacting with behaviors of counter-sense, the first one trying to install themselves and gain field, while the last ones uncouple reluctantly from the field of the economic and social life.

Both the emergence and the disappearance of these two forms, totally different with respect to the institutional behaviors, depend on the positive or the negative evolution of the transition from the Marxist socialism to the liberal capitalism, the concrete internal and external conditions defining the environment of the transition, the relationship between the pros and cons of the real transformations etc.

Therefore, a positive evolution, as dominant trend, provides the normal affirmation of the adequate institutional behaviors, while a negative evolution, on counter-senses of the essential parameters of the economic and social life, maintains the old and non-adequate institutional behaviors, hindering the emergence and the manifestation of the pure and hard core of the necessary and desirable transformation in the economy and society.

Given the particularities of the transition period from the centralized Marxist socialism to the decentralized liberal capitalism, the institutional structuring of the economic and social life is exposed to the combined influence of two categories of institutional behaviors. For this reason, the professor Emilian Dobrescu thinks that "the economy of transition, at least in the case of Romania, is weakly structured because:

- for a large part of the national wealth, the rights of property are not clearly defined;
- the economic life is characterized by a mix of old and new rules, that intermediate the relations between the human beings;
- the discretionary intervention of the public authorities is intense and exposed frequently to certain political combinations of circumstances;
- the formal institutions are immature and loose, while the informal institutions have a very important role in the economy and society".

As weakly institutionally structured economy, the transition economy of our country operates in the conditions of certain overlapped behaviors, of a mix between the old and new rules, so there is not a pure state of the existing institutional structures in the real economic-social life, each of them being impregnated more or less by one side or another; the old by the new, and the new by the old, so that with difficulty one can identify a dominant line of behavior. As a consequence of this situation, the struggle with the inevitable negative externalities of such a process generates both desirable effects for the success of the transition, and perverse effects, non-desirable ones. The most conclusive example in this



sense is the fact that, during this period of transition, at least in our country, emerge and develop “arm in arm” both the legal economy, and the illegal one as well. The relationship between these two forms of the practical manifestation of our economic life became almost equal with the unity, i.e. the combined influence of these two types of institutional behaviors, normal and non-normal, is almost equal, the evolution of the essential parameters of our economy, in their measurable part, records the “visible” part, while the “invisible” part, non-measurable one, is represented by the underground activities, real ones, but not registered by the national accounting system.

Although the economic activities from these two forms of economy, accounted and not accounted, seem to be separated, in reality they belong, with their inputs, transformations and outputs, to the system of our economy, each of these defining element being interlaced.

In these conditions, their impact over the economic aggregates is simultaneous, but of opposite sense, this impeding us to have an image as much as possible neared to the realities of the economic life. For this reason, the macroeconomic and macro-social indicators are far away from reflecting the real activities of the economic agents during this period of time!

Each of the essential parameters of the economic life integrates deviations connected not only with the statistical imperfections of the computation methods, but also with reference to what is obtained effectively in the economic activity.

Therefore, from the point of view of the *real output*, during this period of transition, we assist at a negative impact, related to the efficiency, generated by the use of the national wealth elements, this due either to the ambiguities concerning the rights of property over the factors of production, or as a consequence of the fragility that characterizes the new rules of the economic game, in the conditions of the presence of certain actions with economic destructive character, such as those that have been related to the restitution of social shares, the division (destruction, breaking up) of the patrimony, the material wealth of the agricultural cooperatives “brick with brick” between the peasants etc. and the shocking disappearance of the old regulations concerning the planning and the economic contracts, although the economic environment was structured, as functionality, upon such rules and mechanisms!

*In the conditions of a institutionally non-structured economy the total legal output is always smaller than that provided by a institutionally structured system.*

With regard to the total output, accounted and not accounted one, it is very difficult to establish if in an institutionally structured economic system this is greater or smaller than that generated by a not-structured system or by a weakly institutionally structured system.

What we can find out is that the underground economy in the NGP of the institutionally not structured systems has a weight much more with respect to that existing in the adequately structured systems. So, according to certain estimations, in France the weight of the underground economy in NGP was in 1998 of 6%, in Japan between 3-4%, in Norway between 5-6%, in USA between 10-11%, while in Hungary between 30-31%, Poland 35%, Spain 21-22% etc.

The size of the real output provided by an economy has the mark of the relationship between the accounted economic activities and those not accounted. While there is a series of methods for the quantification of the not accounted economic activities, still, until the present time we do not have conclusive solutions in this sense.

In the economies in transition from the Marxist socialism towards the liberal capitalism, the real output is also under the influence of *certain factors connected with the demand and the offer that favor the multiplication and the amplification of some forms of inefficiency in using the factor of production.*

One of these factors takes into account *the persistence of a large number of capacities of production without performance*, especially in industry, for whose operation it is necessary to allocate important economic resources, this being equivalent with a high level of wasting them.

In this case, limited economic resources are used not where they have the lowest cost of opportunity, the output of corresponding activities is much lower than the level of performance allowed by an institutionally structured economic system according to the criteria of the competition market.

More their number is reduced, more are provided the premises for using the limited economic resources in the fields with a low cost of opportunity, so that the output of the economic activities becoming closer to the performances of the institutionally structured systems, in accordance with the rules of the economic competing game.

The size of the real output during the transition period is affected also by the *existence of an important volume of under-used assets or completely abandoned*, as a consequence of certain institutional unclear points, delaying of certain processes of restructuring and privatization etc.

Given an institutionally structured economic system, with clear rules of using the factors of production, these assets can be a segment of high performance in the economy, with positive consequences for the incomes of those owning the factors of production, and for the general economic output.

Another important factor, with origins in the restitution of the social shares, that contributes to the weak increase of the output, is *the under-capitalization of a large number of economic agents*, a process that delays the flows within the economic circuit, maintains their functionality – much more under the real possibilities – conferring an exaggerated role to the financial-monetary resources in achieving the economic performances.

To these factors that have an influence over the real output, from the offer, we could add, for this period of transition, also *the extreme strong fiscal pressure, especially over the incomes of the work factor*, this limiting the absorption capacity of the householders, and the propensity for their saving, generating the development of the activities within the underground economy, beyond much more over the natural limits of this process.

While the persistence of a large number of capacities chronically with low performances and the existence of a large volume of under-used assets or completely out of operation are the expression of the process involving the institutional transformation of the economic system, the under-capitalization of an important segment of the economy and the extremely high fiscality have their origin in the *non-adequate policies of this period of time*, they being possible to be eliminated through the effort done and the evolution of the reform in economy.

Therefore, the real output of the economy, during this period of transition, is affected firstly by factors that refer to the *nature of the process of institutional transformation of the economic system*, which, through their existence, moves away the reached level from that possible and necessary. At the same time, upon the background of the action generated by these *endogenous factors* of the process of institutional transformation, can emerge, secondly, also *exogenous factors*, such as the under-capitalization of the economically active agent, or the excess of fiscal obligations related to the incomes from work. As a consequence of the action provided by these exogenous factors of the process for the institutional transformation of the economic system, the capacity of the

economically active agents to react to the signals provided by the markets has the mark of the lack of liquidities; in a such economy the necessary "oxygen" for a normal breath, for maintaining the economic activity at the parameters imposed by the rules of the competition game is absent.

The real output of the Romanian economy during the transition period is affected also by *level of the budgetary expenditures, especially through the weight of the fiscal obligations and that of the public deficit in the internal gross product*. Such a factor, seen from the perspective of the aggregated offer, is manifesting, firstly, through the *intensity of the fiscal obligations* which, according to the Laffer's curve, is correlated negatively with the real output of the accounted economic.

At the same time, the covering of the budgetary deficit from internal resources, generated, secondly, a negative effect over the necessary liquidities to the companies, these not having at their disposal nothing else than the volume of liquidities at a high cost, this exerting a negative influence over the performances of the businesses.

Besides these direct factor affecting the negative evolution of the output in our country, at the present stage, there are, in the vision of the analysts, also, indirect factors, connected with the aggregated demand, that mark this evolution.

In the category of these factors, the acquisition power of the private households in our country, in the after 1989 period of time, represents a extremely strong restriction that affects the non adequate evolution of the real output.

On the background of incomes really low ones and in permanent diminution for the overwhelming majority of the private households, the level of the private consumption of good of large use and services chokes the final reach of the real output, giving a non adequate impulse to the economic segment that produces these economic goods.

By virtue of the principle of accelerator, the signals given by the absorption capacity of our domestic market, in the zone of the goods of large use and services, generate, by means of the coefficient concerning the technical capital, an unfavorable impulse for the evolution of the real output of goods of production.

From this results another restrictive factor for the evolution of real output in our country, namely *the limited investing potential of the economy, the net formation of the technical capital being outstripped by the investment of replacement*, with serious consequences for the formation and the development of the stock of technical capital,

productive one at the level of certain companies with a high level of economic concentration and competition performance.

In a close connection with these two factors, the evolution of the real output generated by our national economy during this period of time is confronted with *serious difficulties of adaptation to the requirements of the Western markets* towards more and more are directed the commercial flows of Romania. As a result of this fact, there are registered *loses of added value in the commercial relations* with the developed countries, a direct expression of the difference of competitiveness between our exported goods and the external performances of the Western markets.

*As a conclusion, the real output of our national economy during this period of time has a restricted evolution both at the entrance, and the exit as well, through the factors that affects the activity of economic agents producers and consumers, generating movements of sense, but also of counter-sense, within the institutional transformations that take place in the economic and social life.*

In this context of interdependencies, the Romanian economy is in a chronic deadlock from the point of view of competitive performance. The deficit of economic performance of our country, in comparison with the States Members of the European Union, has an institutional origin, which, at its turn, has the objective basis in the character of weakly institutionally structured system of the Romanian economy.

Without neglecting such an argument, we think that the deficit of economic performance registered and permanently increasing by the economy of Romania, as a whole picture, in comparison with the countries from EU (at least), after 1989, is not the result of the fact that the system of our economy is weakle structured, but the result of the destructuring the old economic system of the Marxist socialism without a viable project of institutional reconstruction at the level of the economic agents and that of the policies implying the economic and social macro-structuration.

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# THE ANALYSIS OF POTENTIAL OUTPUT GROWTH IN THE EURO AREA

■

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**Abstract.** *I review the recent performance of the Euro area economy, focusing in detail on the separate roles played by labour input, capital input, and total factor productivity (TFP). The reduction of the economic growth rate is mainly due to the poor rate of Euro area TFP growth (0,3 percent per year between 2000 and 2006). Based on prevailing trends, I estimate that potential output growth in the Euro area currently may be running as low as 1.5 percent per year. In addition, if TFP growth stays at recent levels, the output growth rate will decline further due to weaker capital deepening.*

**Key words:** euro area; economic growth; total factor productivity (TFP); labour productivity; Solow model.

**REL Classification:** 8E; 3D.

■

## **The sources of economic growth in the euro area**

The countries of the euro area registered a reduction of labour productivity and smaller growth rate of potential GDP (1.8 percent in 2006 compared with 2.25 percent in 2000). I analysed the impact of labour force on the economic growth with indicator *total hours worked*, which can be defined as the product of four elements: population times labour force participation rate times employment rate times hours worked per employee.

Total hours worked = Total population  $\times$  (Labour force/Total Population)  $\times$  (Employed population/Labour force)  $\times$  (Hours worked/Employed population).

Table 1 also provides an accounting decomposition of growth in hours worked over various periods into its four components.

$$\text{Total hours} = \% \Delta \text{ Population} = \% \Delta \text{ Participation rate} + \% \Delta \text{ Employment rate} + \% \Delta \text{ Hours per employee} \quad (1)$$

#### Labour's decomposition

Table 1

	Total hours worked	Total population	Participation rate	Employment rate	Hours worked per employee
1990-2000	0.3	0.4	0.2	0.0	-0.3
1996-2001	1.3	0.4	0.7	0.6	-0.4
2001-2006	0.5	0.6	0.2	0.0	-0.2

Source: McQuinn and Whelan (2006).

In recent years, the rate of population growth in the Euro area has moved up to about 0.6 percent, largely due to increased rates of immigration, most notably from Eastern European countries that have joined the European Union. After retreating somewhat in the late 1990s, unemployment rates in the Euro area have remained relatively steady at a high rate of about eight to nine percent during the current decade. The average hours worked per week for each person employed reduced during three periods analysed (with 0.3 percent between 1990-2000, 0.4 percent for 1996-2001 and 0.2 percent for 2001-2006).

In addition to labour input, capital investment is another important factor determining labour productivity. For this reason, it is generally considered that one can get a better picture of how well an economy uses its resources by focusing on total factor productivity (TFP), which is defined as the efficiency with which it combines its labour and capital inputs to produce its output.

My starting point is the standard assumption that output is produced according to a Cobb-Douglas production function:

$$Y = \text{TFP} \times K^{\alpha} \times L^{1-\alpha}$$



where Y is real GDP, K is capital input, L is labour input (defined as hours worked), and TFP is total factor productivity;  $\alpha$  represent the share of capital in real GDP (the standard value is  $\alpha = 0,33$ ).

Output growth can then be written as :

$$\Delta\%Y = \alpha \times \Delta\%K + (1 - \alpha) \times \Delta\%L + \Delta\%PTF \quad (2)$$

Table 2 presents more detailed results from a growth accounting exercise which allocates output growth according to its three components.

**Decomposition of economic growth rate**

Table 2

	$\Delta\%Y$	$\alpha \times \Delta\%K$	$(1-\alpha) \times \Delta\%L$	$\Delta\%PTF$
1990-2000	2.1	0.7	0.2	1.2
1996-2001	3.0	0.7	0.9	1.3
2001-2006	1.4	0.7	0.4	0.3

Source: McQuinn and Whelan (2006).

The growth decomposition display the higher impact of the TFP between 1990 and 2000. It's registered a decline beginning on 2001, that have generated a economic recession in the euro area countries. Similarly, the labour productivity growth have reduced from 1.8 percent per year between 1990 and 2000 at 0.8 percent between 2001-2006. Table 3 provides an alternative accounting breakdown, describing the determination of labour productivity growth as a function of TFP growth and "capital deepening" (growth in capital per unit of labour). In other words, it provides the figures behind the identity:

$$\frac{Y}{L} = TFP \times \left(\frac{K}{L}\right)^\alpha ; \quad \Delta\% \frac{Y}{L} = \% \Delta PTF + \alpha \times \% \Delta \frac{K}{L} \quad (3)$$

**Decomposition of labour productivity**

Table 3

	$\Delta\%Y/L$	$\alpha \times \Delta\%K/L$	$\Delta\%PTF$
1990-2000	1.8	0.6	1.2
1996-2001	1.2	0.3	1.3
2001-2006	0.8	0.6	0.3

Source: McQuinn and Whelan (2006).

### **Estimating Potential Output Growth. The Medium-Run Outlook**

In this section, I analysed the potential growth rate if current trends in labour markets, capital investment, and TFP continue. McQuinn și Whelan (2006) proposed three different estimates of the potential growth rate of the euro area economy. In Cases 1 and 2, they extract trends from the basic data using the Hodrick-Prescott (HP) filter. The HP filter is commonly used to divide time series into its long-run components and those components linked to the business cycle.

1. Their estimate of the potential growth rate is based on filtering the log of real GDP. This reveals an average annual increase in output of just 1.46 percent. This allows us to decompose this 1.46 percent trend into separate components, with 0.34 percent due to increases in TFP, 0.73 percent due to capital growth and the remaining 0.39 percent due to the rate of increase in total labour hours. Similarly, the decomposition of total labour hours shows that most of the increase is coming from the increase in population levels. This increase of about 0.6 percent per year contributes 0.4 percent yearly. However, the total labour contribution is reduced marginally by a decline trend in the average workweek (-0.09 percent) which is estimated to be a bit stronger than the contribution of the positive trend increase in the participation rate (0.07 percent).

2. They switch off the changes in participation and the workweek and assume that the only change emanating from the labour market is due to the growth in the population. Therefore, they are assuming that there is no net change in hours worked per capita. This produces an estimate of potential output growth of 1.49 percent.

3. Realization of present trend growth rates for each output component based on averages over the period 2000 and 2006. They choose this period because it represents something close to a full business cycle: output growth was strong during early 2000, the economy then went into recession, and has since subsequently recovered. For reference, the unemployment rate in 2006 has been about 7.9 percent, which is close to the 8.3 percent value prevailing in 2000. As such these results provide a type of common-sense alternative measure of the trend growth rate, providing a simple form of business-cycle adjustment. These results turn out to be only slightly stronger than the other estimates, producing an average growth rate of 1.62 percent, with 0.34 percent due to increases in TFP, 0.73 percent due to capital growth and the remaining 0.39 percent due to the rate of increase in total labour hours.

In general, all the results suggest that the medium-term outlook for potential Euro area GDP is a growth rate of approximately 1.45 to 1.62 percent. However, it should be noted that an important factor in this estimate is the relatively strong contribution from population growth. This pattern has been largely due to the inward migration from Eastern Europe associated with the enlargement process. As this process enters a more mature era, it seems likely that population growth and thus hours worked will slow down, implying a further decline in potential output growth. As well, in the medium to longer term, the labour supply will influence to a large extent be determined by demographic developments. The available long term projections by national statistical institutes suggest that population growth in the euro area will decline over the period up to 2020 and that after this point the population will shrink in absolute terms. Moreover, the negative impact that this would have on the potential labour supply is reinforced by the fact that the share of older persons is expected to rise and lead to a concomitant increase in the dependency ratio.

Musso și Westermann (2005) have analysed the consequences of this demographic evolution on the economic growth rate. In the case where developments in labour utilisation maintain unchanged dynamics compared with those in the 1990s, the adverse demographic developments would reduce average real GDP growth in the period up to 2010 to 1.8% and in the period up to 2020 further to around 1.6%. If real GDP growth were to be sustained at the level of 2%, *ceteris paribus*, this would for instance require growth in the participation rate of around 0.8% yearly, considerably stronger than in any period of the past. An another projection assumes that the employment rate (as a percentage of the working age population) reaches 70% in 2010, as stated in the targets set in the Lisbon agenda for Europe. Applying this target also to the euro area and considering that some countries have already achieved relatively high employment rates, the target implies considerable adjustment pressure on the remaining countries. The mechanics of the growth accounting framework suggest that the Lisbon employment target can be achieved by more quickly raising participation or by more quickly reducing the unemployment rate. *Ceteris paribus*, the participation rate would need to increase by 0.9% per annum, reaching a level of 76% in 2010, while the unemployment rate would have to decline by 0.4 percentage point per annum to a level of 6¼% in 2010. In each case the associated increase in labour supply growth would raise average real GDP growth to 2.1%, slightly higher than in the 1990s but still slightly lower than in the 1980s.

### The impact on the economic growth. The Longer-Run Outlook

McQuinn și Whelan (2006) investigated the implications over a longer-run context using the Solow growth model as an analytical framework. This is based on a standard production function, a constant rate of TFP growth and a constant share of real investment in GDP ( $K/Y$  ratio). This model provides a useful way of thinking about the linkages between medium- and long-run growth rates. To describe this, I start by defining the capital-output ratio; output per hour can now be expressed as (4) :

$$\begin{aligned}
 Y &= TFP \times K^\alpha \times L^{1-\alpha}, \\
 \frac{Y}{L} &= TFP \times \left(\frac{K}{L}\right)^\alpha = TFP \times \left(\frac{K}{Y}\right)^\alpha \times \left(\frac{Y}{L}\right)^\alpha \Rightarrow \left(\frac{Y}{L}\right)^{1-\alpha} = \\
 &= TFP \times \left(\frac{K}{Y}\right)^\alpha \Rightarrow \frac{Y}{L} = TFP^{\frac{1}{1-\alpha}} \times \left(\frac{K}{Y}\right)^{\frac{\alpha}{1-\alpha}}
 \end{aligned} \tag{4}$$

Relative to the more familiar decomposition of output per hour into TFP and capital-per-hour terms, this decomposition has an important advantage. The long-run capital-output ratio can be shown to be independent of the level of TFP, something which is not true of capital-per-hour. Hence, this formulation completely captures the effects of TFP on long-run output, while the more traditional decomposition features a capital deepening term that depends indirectly on the level of technology. In the Solow model, the capital-output ratio influence the steady-state level of the labour productivity (determined as  $Y/L$  ratio).

$$\lambda = (1 - \alpha) \times \left( \frac{tfp}{1 - \alpha} + l + \delta \right) \tag{5}$$

Where

$tfp$  – PTF growth rate;  $l$  – population growth rate (0.6 percent per year);

$\delta$  – depreciation rate of capital (6 percent per year).

These calculations show that, over the long-run with constant values for  $tfp$  and  $l$ , the capital-output ratio converges to its steady-state. Thus, equation (5) tells us that all growth in output per hour ends up being due to the  $TFP^{1-\alpha}$ . This term grows at rate  $\frac{1}{1-\alpha} \times tfp$ . Thus, in this

example with TFP growth of  $\text{tfp} = 0.35$  percent and a value of  $\alpha = 0.33$ , the long-run growth rate of labour productivity is  $\frac{0.0035}{3} = 0.0052 = 0.52\%$ .

The analytics of this long-run scenario can thus be explained as follows. My calculation show that the Euro area capital-output ratio is currently below the value consistent with the steady-state implied by these parameters. For this reason, the economy undergoes a long period of transitional growth with labour productivity growth being slightly higher than its long-run 0.52 percent value. Over time, however, the capital-output ratio approaches its steady-state level and labour productivity growth transitions towards 0.52 percent. With a 0.6 percent trend for hours worked, this implies a steady-state growth rate of 1.12 percent per year. These calculations show that, over the long-run, the current trend growth rate of TFP would imply an even weaker growth rate of output per hour than is implied by our medium-run estimate of 1.5 percent.

### Conclusions

The composition of recent growth suggests the potential for a further worsening of the Euro area's productivity performance. Recent growth has relied heavily on increases in capital and labour inputs, with very little improvement in Total Factor Productivity, which measures the efficiency with which inputs are used. I have used the Solow growth model to illustrate how the continuation of recent rates of TFP growth will lead to a further decline in productivity growth.

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## ROMANIAN COMPANIES COMPETITIVITY REGARDING THE EUROPEAN BUSINESS ENVIRONMENT



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***Abstract.** One of the main challenges which is addressed to the Romanian economy is that if the integration in the European Union represents a moment of discontinuity.*

*It is to mention that the custom duties were abolition between Romania and the European Union (January 1<sup>st</sup>, 2004) made the Romanian companies to be in a direct competition, at least at the product markets level, with the companies in the European area. From this point of view, it can be appreciated that the Romanian integration effect will be quite low and the “danger” of integration is many times over dimensioned.*

**Key words:** indexes of competition appreciation; European business environment; Lisbon Strategy; the effects of the integration in EU upon the Romanian companies.

**REL Classification:** 7H, 14K, 20B



One of the first steps in establishing the strategy to be followed by the Romanian companies on the European Single Market is the trial of valuating their competition in comparison with the European business environment.

Since 1979, *The World Economic Forum* in Geneva published the Global Report upon Competition, by which it tries to synthesize the competitive position of the national economies internationally. Among

the indicators performed by this institution, the increasing competition index represents one of the most known indicators used in literature regarding the international economy. The World Forum (WEF) is an international independent organization which intend to promote the world economy conditions improvement. Starting the activity since 1971, WEF is a non-profit organization which reunites over 1000 companies of global stature as well as over 200 smaller business from the Third World.

The Annual Forum Meetings reunite representatives from over 100 countries.

*The increasing competition index* takes into consideration three main elements: technology, public institutions and the macro-economic conditions.

*The macro-economic stability* is considered to be essential for the economic increasing. Although most of the economists argue that the stability itself does not generate economic increasing, the macro-economic indicators instability may question every increasing potential. The companies are not able to take any decisions of investment in economic environments where the hyper-inflation is present, and an excessive fiscality can make investment projects profitable by their economic nature to become not rentable.

*The public institutions* are also essential for the economic increase. Although in a market economy the prosperity is generally created by the private entities, they obey the public regulations and, especially, by their interactions with the public authorities, can be impeded in their activity. For example, an ownership system in which the juridical system is efficient in defending and reestablishing the violated rights is essential for the well developing of the economic activities. As a matter of fact, the economic science approaches more and more often the institutional organization impact upon the macro-economic performances of different countries.

The third element regarded by the global competition index is *technology*. An economy increase cannot be performed on a long-term only in the technological progress conditions.

The three elements are not, obviously, independent: powerful institutions are necessary for the macro-economic stability, and this promotes the technological innovation. According to this index, the most competitive economy in the world was, in 2005, Finland, followed by the United States, Sweden, Taiwan, Denmark, Finland and Norway. Thus, three from the first six countries of the world, according to this index, are members of the European Union.



**Ranking of national economics on international level***Table 1*

Country	Position 2005	Score 2005	Position 2004	Country	Position 2005	Score 2005	Position 2004
Finland	1	5.95	1	Slovenia	33	4.75	31
USA	2	5.82	2	Lithuania	36	4.57	40
Sweden	3	5.72	3	Hungary	39	4.56	33
Taiwan	4	5.69	5	Czech Republic	40	4.55	39
Denmark	5	5.66	4	Slovakia	43	4.43	43
Norway	6	5.56	9	Leetonia	44	4.43	37
Singapore	7	5.56	6	Bulgaria	59	3.98	64
Switzerland	8	5.49	7	Poland	60	3.98	45
Japan	9	5.48	11	Croatia	61	3.94	53
Island	10	5.44	8	Romania	63	3.86	75
Great Britain	11	5.30	15				
Holland	12	5.30	12				
Germany	13	5.28	13				
Australia	14	5.25	10				
Canada	15	5.23	16				
EAU	16	5.21	-				
Austria	17	5.20	17				
New Zealand	18	5.18	14				
Israel	19	5.09	20				
Estonia	20	5.08	22				

**Source:** Growth Competitiveness Index 2005, World Economic Forum.

**The Lisbon Agenda: the European competition future  
and the impact upon the company strategies**

In March 2000, the heads of state and government from the EU, with the occasion of the Lisbon European Council, declared the intention of transforming the EU in “the most dynamic and competitive economy in the world based on knowledge”, able of a sustainable rate of economic increase, with more and better places of work, with a bigger economic cohesion”. This statement, known under the name of Lisbon strategy upon the economic and structural reforms, aims a time horizon until 2010.

*The Lisbon Strategy* may be differentiating on eight big dimensions:

1. an informational society creating for everybody;
2. an European area developing for innovation, research and developing;
3. the liberalization, respectively:  
a single market performance;  
the state subvention and the policy regarding the competition;
4. network type industries building:  
in telecommunication;  
in utilities and transports;
5. the creation of an efficient and integrated industry of financial services;
6. the business environment improvement for the companies:  
accent on the start-ups;  
the regulation frame;
7. the social inclusion increasing:  
the labour force qualification increasing at the European level;  
the social insurances system modernization;
8. the accent on the lasting developing.

It is to mention the fact that this agenda has been formulated in March 2000, in the conditions in which the European economy, as well as the international one, knew an increase considered extraordinary, and the macro-economic conditions in all the member states were extremely favorable.

The main challenge of the European economy was considered to be labour market reform in order to solve:

- the high unemployment issue, traditionally present in Europe beside other developed economies like of the United States of America's or Japan's;
- a marked equality between sexes regarding the occupation rate;
- a perceived delay lowering regarding the labour force qualification especially in the intensive technology, considered to have- in the propagation conditions concept of "The New Economy" and the connected one of "economy based on knowledge"- a higher and higher contribution at the economic increase and the industrial dynamics.

The agenda objectives from Lisbon are orientated, as it can be seen, more on a long time and not a short horizon. The aim of this agenda is realizing the essential reforms for a resettlement of the European economy.

The World Economic Forum tried to synthesize the European countries evolution in the member states (the 15<sup>th</sup> members plus the 10 new ones) as well as the left adherent countries (Romania, Bulgaria and Turkey) – beside the agenda objectives from Lisbon.

### European countries against objectives of Lisbon agenda

Table 2

Country	Final Index		Sub index							
	Position	Score	The Informational Society	Innovation. Research and Developing	Liberalization	Network Type Industry	Financial Services	Companies	Inclusion	Lasting developing
Finland	1	5.80	5.78	5.87	5.36	6.33	6.13	5.48	5.46	5.97
Denmark	2	5.63	5.68	4.87	5.14	6.51	5.96	5.60	5.52	5.78
Sweden	3	5.62	5.71	5.57	4.91	6.37	5.80	5.29	5.46	5.89
Great Britain	4	5.30	4.96	4.67	5.11	5.78	6.1	5.62	4.86	5.30
Holland	5	5.21	4.99	4.46	4.94	6.04	5.67	4.71	5.29	5.57
Germany	6	5.18	4.95	4.90	4.64	6.38	5.62	4.64	4.37	5.96
Luxemburg	7	5.14	4.98	3.57	4.96	6.22	5.72	5.17	5.19	5.28
France	8	5.03	4.52	4.68	4.65	6.10	5.68	4.68	4.72	5.20
Austria	9	4.94	4.69	4.27	4.54	5.76	5.48	4.28	4.88	5.64
Belgium	10	4.88	4.08	4.45	4.63	5.74	5.39	4.69	5.12	4.91
Ireland	11	4.69	4.14	4.18	4.47	4.89	5.59	5.30	4.62	4.35
Spain	12	4.47	3.71	3.93	4.50	5.34	5.14	4.32	4.38	4.48
Italia	13	4.38	3.94	3.87	4.40	5.30	4.92	3.64	4.24	4.74
Portugal	14	4.25	3.88	3.44	4.10	5.35	4.90	3.89	4.15	4.29
Greece	15	4.00	3.16	3.44	3.96	4.99	4.74	3.78	3.90	4.00
USA		5.55	5.86	6.08	5.11	5.85	5.82	5.71	5.04	4.96

**Source:** Growth Competitiveness Index 2005, World Economic Forum.

It is to remark the privileged position of the states in north European Union, those which are the advanced ones in the policies implementation and to facilitate the stated objectives achieving. It would made the parallel with the United States of America interesting, economy with which the European Union is in competition for the economy supremacy holding.

#### **Economical performances of UE states in comparison with USA**

*Table 3*

<b>Criteria</b>	<b>US Score</b>	<b>UE Score</b>
An informational society for everybody	5.86	4.61
Innovation. research and developing	6.08	4.41
Liberalization:	5.11	4.69
- the Single Market performance	5.70	5.13
- the state subvention regarding the competition	4.52	4.25
Network type industries:	5.85	5.81
- telecommunication	5.60	5.96
- utilities and transports	6.10	5.65
Integrated and efficient financial services	5.82	5.52
The company environment:	5.71	4.74
-conditions for new business	5.83	4.52
- regulation environment	5.58	4.96
Social inclusion:	5.04	4.81
- the competence improvement	5.31	4.96
- the social protection modernizing	4.20	4.40
The lasting development	4.96	5.16
Scores per whole regarding the Lisbon Objectives	5.55	4.97

**Source:** Growth Competitiveness Index 2005, World Economic Forum.

Thus, unfortunately for the European Union, the USA is more advanced, it might be said, in the Agenda from Lisbon objectives achieving. The single criteria in which the European Union is passing beyond the USA is the lasting developing, fact which rises important challenges to Romanian policy governance.

### New member states and the adherent countries

The new member states situation as well as the adherent ones points out the fact that the European Union will have higher difficulties together with the integration progress of these economies in the Single Market. It can be remarked that the three most advanced (Estonia, Slovenia, Malta) from the new member states passed beyond even some old members of the Union (the four weakest performers – Greece, Spain, Portugal and Italy).

### New member states ranking by economical performances

Table 4

Country	Final Index		Sub index							
	Position	Score	The Informational Society	Innovation. Research and development	Liberalization	Network Type Industry	Financial Services	Companies	Inclusion	Lasting developing
Estonia	1	4.64	4.92	3.82	4.40	4.98	5.43	4.90	4.20	4.44
Slovenia	2	4.36	4.38	3.92	4.06	5.21	4.89	3.76	4.24	4.60
Leetonia	3	4.34	3.62	3.86	4.44	4.35	4.84	4.87	4.47	4.29
Malta	4	4.20	4.42	2.99	4.03	4.81	5.27	4.00	4.83	3.24
Czech Republic	5	4.16	3.62	3.34	4.01	5.19	4.03	4.18	4.40	4.48
Hungary	6	4.12	3.24	3.47	4.10	4.57	4.87	4.41	4.19	4.09
Lithuania	7	4.05	3.36	3.57	4.10	4.51	4.67	4.38	3.69	4.17
Slovakia	8	3.89	3.29	3.34	3.84	4.50	4.39	3.43	3.83	4.53
Poland	9	3.68	2.95	3.53	3.75	4.00	4.26	3.56	3.42	3.99
Turkey	10	3.45	2.81	2.72	3.68	4.01	3.99	3.84	3.45	3.33
Romania	11	3.35	2.91	2.88	3.04	3.48	3.77	3.65	3.74	3.33
Bulgaria	12	3.25	2.66	2.94	3.26	3.54	3.64	3.81	3.07	3.08
Media UE		4.97	4.61	4.41	4.69	5.81	5.52	4.34	4.81	5.16

Source: Growth Competitiveness Index 2005, World Economic Forum.

Thus, Romania is on the last but one position, but at the same score with Bulgaria, passing it beyond at the Informational Society criteria, Financial Services, Social Inclusion and Lasting Developing, but is passed beyond at the criteria that regard Liberalization, and Innovation and Research and Developing.

It is to mention the important leap made by Romania in 2005, passing from position 75 (2004) at 63 (2005). The most significant evolution took place on the micro-economic and macro-economic criterion. The biggest obstacles this index met are appreciated to be: the high level of the interest installments as well as the fiscality weight. It is to mention that these two elements are in a continuous process of improvement (end of year 2005 and beginning of 2006), fact that will be concretized in a better positioning of Romania in the near future.

One of the most significant evolutions is yet in the domain of the human principal training in the technology area. In Romania there are annually qualified about 5000 young people in the Information and Communicating Technology, from the total of 30,000 engineers. In a classification made on geographical areas, Romania is on the first place in Europe and sixth in the world, with the biggest number of authorized specialists in 30 from the most important domains of the information technology. The total number of specialists in the Information and Communication Technology domain is of 63,600, from which 45,444 work in the private sector, from these, 18,800 works in the software domain.

According to the estimations 21,5% from the public sector employees use the and communication technology instruments in their daily activities.

It is less probable that the Romanian economy allow some actors to appear that might compete from the point of view of the technology with European and global developed countries and aeriels, because the local market is not able to allow the commercial exploitation of these kind of technologies, and the European market marking will probably rise the interest of the European actors.

In consequence, it can be appreciated that the Romanian competitive advantage will have its origin in those sectors that need low principal investments, mature technologies (not innovating ones) and a high contribution of the human factor. The sector which seems best

drawing to a close this profile is the software production one, and the mentioned above evolutions are gladdening.

The cost advantage of the labour force will still spread in the direction of delocalization of the intensive industries in this production factor to the East of Europe, being able to state that this process will aim Romania in a favourite way. However, it has been made the speculation that this kind of competitive advantage can be only temporary until the moment in which the development of the whole of the economy and the natural increasing of the incomes make Romania lose from this advantage. Thus, it might be appreciated the time horizon could be of maximum ten years, until the moment in which the problem of the integration of Ukraine will be pointed. In this period, the Romanian economy must identify other sources of the competitive advantage than the one based on the low cost of the labour force.

One of the main challenges which is addressed to the Romanian economy is that if the integration in the European Union represents a discontinuity moment. It is to be mentioned that the custom duties abolishing between Romania and the European Union (January 1<sup>st</sup>, 2004) made the Romanian companies to be in a direct competition, at least at the product markets level, with the companies in the European area. From this point of view, it can be appreciated that the Romanian integration effect will be quite low and the “danger” of integration is many times over dimensioned.

Many successful companies on the local market will be took over by big European concerns, as a consequence of the natural tendency of their consolidation at the whole communitarian area level. The Romanian companies must identify niche markets, respectively to adopt a focalization strategy, that could be relatively uninteresting for the big actors at the European level. The Darwinist theory sustains the following statement: as more you get through an intense competition, the more those who survive will be powerful, thus the integration of the Romanian economy in the European economic area will automatically train the industrial reorganization. Already this integration is powerfully performed.

The Romanian integration in the European Union is, in this way, an event with a real impact much lowered than the discounted one. The statute of state member will still put a mark on the strong enough differences, too:

- the more urgent surveillance of the macro-economic discipline;
- totally appliance of the European Union policy in the competition domain, which might make enough difficulties to the Romanian companies in the utility domain, telecommunication, etc., which still profits of dominant positions;
- a better running of the institutional system, especially what concerns the ownership rights protection.

From the point of view of the way of penetration on the Single European Market, it cannot be formulated, obviously, a good choice for all the economic agents in Romania. But the most probable, those who have some kind of competition and are intensively in technology, in case of which they will remain independent (they will not be acquired by great concerns in the Triad), they might identify partners in order to establish mixed companies to aim a strategy per the European continent whole.

The European business opening, together with the integration of Romania in the European Union, will mean a bigger liberty of the Romanian companies to penetrate on the other European states markets. At their turn, the ease of the European companies of penetrating in Romania will be translated in the powerful pressures upon the Romanian companies. Thus, even if they will be quicken by pro-active or only reactive motivations, the Romanian economic agents, in order to get through the new grouping competition, will have to adopt European level strategies and not to be satisfied only with the experience and bundles they have with the Romanian market. Because Romania will have many competitive advantages in what concerns the production costs, the most probable that the Romanian companies presence on the Single European Market will take over the form of some distribution branches.



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**Notes:**


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<sup>(1)</sup>As given in Muşetescu, A. – “The Impact of the integration of Romania in the European Union upon Romanian Companies Competition”, communication at the Scientific Session “Economical-social and Political-juridical Implications of the integration of Romania in the European Union”, UCDC – Bucharest, May 27<sup>th</sup>, 2005

<sup>(2)</sup>The publishing series “The Lisbon Review, on the years 2004 and 2005

<sup>(3)</sup>The Romanian Government – “The Developing Plan 2004-2006”, Bucharest, 2004

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## VERTICAL INTEGRATION AND DEVELOPMENT POTENTIAL FOR EUROPEAN UNION

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**Abstract.** The setting up of EU leads to the changed manner of how firms make choices through the shifts of dimension for competition space and change the way of meaning for national economic development. The possibilities of an increasing marginal profit make that the European firm could choose more often for external collaboration in production process. Although the process is at the beginning and requires a long time to accomplish, I suggest another vision on the connections in an economic system. The links between macro- economical fields have been transformed into the links between individual economic agents.

**Key words:** Vertical integration; concurrency; multinational firm; European integration; European Union.

**REL Classification:** 7, 10H, 20B

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The powerful opening of the market occurred through integration leads to a new dimension of the option “to make or to buy” for European or outside firms. Through union economic reinforcement the sale market became larger for a firm which activates in national spaces of EU. This aspect is simply observed in specific literature and at profane observers. Unfortunately, in many cases the economists concentrate only on these aspects, due to a powerfully clamping in ethically concern and thanks to the retentively in Friedrich List idea. However the potential for economical development is changed in the new conditions of sales or supply market. The firms activate today in Europe in a more large market for production factors and for potential resources. In this context firms make more often its choice between to produce by itself or to externalize a phase in production process. The effect of extinction of this vertical integration process is determined by the extinction of spaces for economic action in condition of efficiency and

diversity in growth, in condition of monetary cost and physically consumption in downward. It is difficult or even impossible to see how many of these are due to the specified process itself, in condition suppose free migration: for persons, it is improve the allocation on the labor market and asymmetric information state; of capital, it is improve technology and moral hazard made by the financing possibility for business;- suppose unique currency and lack of tariffs barrier which affect equilibrium in concurrency (Arrow,1975). Union multiculturalism can contribute to the decrease of limited rationality generated by the cultural differences. However, vertical integration leads to the increasing of efficiency thought which the national governments follow economic development.

The firms begin to decide more and more to buy the intermediary resources from external market in prejudice of internal market of firm, (Harrigan, 1985). The option of vertical integration followed in prejudice of corporatists' vision of realizing the production in the same property rights structure came to consolidate the business efficiency thought the choosing the lowest cost for products. The growth of marginal products is realized in condition of earnings made by competition acts. However, the phenomenon of integrated production manages the marginal modifications more complex in changed environment for competition determined by the creation of EU. The way in which this marginal growth consist in economical growth, in modalities of establishing the classic or neoclassic equilibrium migrate through determination of firm equilibrium, without talking about the stability in equilibrium because integration of the dynamics of price level is the same in all national economies (Laffer, 1969). We can observe that the firm choice seeking for concurrencies advantages it's made between the next alternatives:

- The price for production factors and costs for organization;
- The acquisition price and transactions costs.

The firms seek to fructify different factors of the economical environment as long as their value is not longer affected by the existence of diverse custom mechanisms; among these the most explicit are the tariff barriers, but, without ignore, don't forget the monetary value of the certifications in case of imports or the losses caused by the infrastructure differences. With other words, a firm through vertical integration means the value of transfer prices compared with market price of the intermediary product, therefore the firm can be less interested in diversification (Collier and Siebert, 1991). In the case of the integrated German economy, immediately after the Berlin wall fall, the firms started to make choices of positional of the production as if in German economy the principle of compensation should have act, which came to make up for the discrepancies between the endowment with capital and labor (perceived through the

remunerations differences, which in the market theory can be interpreted as differences of the supply and demand value).

On the impact of the foreign investments in real assets or the monetary payments (capitals transfers supposed by the vertical integration, between different national economical systems, indifferent if those are integrated into a unique market or if are individual economic systems), an important role play the capacity of producers to administrate decision (Currie and Kubin 1997), on the market existing various producer's comportments dictate by the proposed objectives and by the available resources. Internal economic process of firm, as capital depreciation and the stage of moral depreciation, investment price, implicit cost of process (resize of administrative department, of infrastructure and human resources, etc), have a significant importance in an investment decision. As long as we'll not accept that the production came off as a linear function as on Marshall and we accept the production as an flux described by a dynamic nonlinear function, we must accept the fact that the investments does not appear as a necessity for firm to replace the old technologies. Investments finalized in a period are decided by the law of concurrency, so economic development it is influenced by the concurrency transformation in EU.

In condition of free trade the nation had the tendency to specialize in conformity with absolute advantages theory. One technical substitution rate above the unity is specific to the fabrication technology based on labor. In internationals competition have to gain those products who offer more technical facilities, have more quality (not in the last have to gain, because this products have big profits given by this products in condition of smallest marginal costs, biggest sales price and for small opportunity cost of replacement in production), and are the result of highest technologies. It is normal for national economy remained behind in the technological field the tendency for savings. This reserves are necessary for financing the future investments witch make possible the technological caper and, make his products more competitive. The tendency to look for absolute advantage is transferred towards firm. The modalities in witch nation try to obtain the absolute advantage cause specific behavior for firm characterized by the finding modality to integrate competitive trumps of partners in different production stage.

One synthetic approach of manner to realize vertical integration betray two principal way to achieve for international business (Muntean, Vâlsan, 1995):

- foreign capital; direct or indirect participation of foreign economic agents to internal investments founds formation;

- Stateless capital; real realization of investments objectives by the transnational firms.

Differences between two type capitals are consistent:

- The first is under national laws; transnational some time can enforce his will;

- The first observed the opportunity (stand out from one comparative advantage) to invest in a different country not in provenance country, stateless firms invest in the country where they can carry on the activity uninterested by the value of comparative advantage in another country;

- The firms can be only venture capital, transnational used only the labor existing in the internal market and this one only partial (this is a criterion for every country where they operate).

In condition of unique economic space which begin to appear as a transformation of unique European market, on the scale of integration rate widen, I think we can talk about more and more firms vertical integrated and more less about foreign investments, for European capital of course. In condition of political power transferred: to down, from region, and to upstairs from international organization, in economy appear multinational firms (Williamson, 1971). This will try to find specific assets as: local assets; real specific assets; human specific assets; devoted assets; reputation. For EU region less developed the resemble rate between activities denote potential activities what can be integrated by the firm established the area of optimal activities (Dinu, 2002). Entrepreneurial potential is natural actively in conditions of unique administrative constraints in Europe.

The European politics of administrative, legislative and institutional harmonization makes that the importance of the business's geographical emplacement to disappear. Even though this politics was disclaimed and unwanted by some economists, it works like catalyser for vertical integration and it limits the business diversification. The UE catalyst character into integration it's emphasized by the regional approach of the development policy which follows a harmonic evolving of the European regions and the reinforcement of the industries traditional character. All these govern to the specific assets strengthening which are looked by the firms in the vertical integration (Lorenz, 1992). The business's geographical emplacement takes into account only of the transportation costs value, mediated by the losses value thought the growth of the organisational dimension which leads to the marginal cost increasing on a long term through communicational issues.

The differences between the internal and purchased production will tend to decrease through the growth of European cohesion and the regional harmonization (Casella, 1992). This process is accomplished, or at least it's seems like as an union principle, not through a trickled of the economical

value from the developed regions to the poor ones (although, during the last time in Romania, a communicational analysis would resist to the economists expectations) but through a simulating and rational redistribution which should be gradual compensated (Sloane, 1968). The criteria used for defying the economical process in this case are very often mixed up with these ones and ultimately remain only political criteria, submissive to this medium debate, mediated by economical knowledge and reason. What is really count is that the process of the systemic revaluation leads to the alternatives transformation in production through the vertical integration for firms.

You shouldn't understand from here that I put so much emphasis on the value of vertical integration up to the point that I oversee a strict over-qualification of enterprises. What I wanted to underline is that the European development potential may grow by rising the opportunity of the integration and by diminishing that of diversification. A better use of the resources by migrating towards the most efficient sources of valorization and the concentration of resources which would eliminate the gainful differences emerged from the geographical positioning surely lead to development. It's difficult and futile to state the degree to which the process will function, this being relevant only for each particular case. In this way an enterprise can reach an over-qualification that would bring about its bankruptcy because of its lack of flexibility to the evolution of the environment.

Even though aren't a few specialists who are seeing in the enlargement of the market dimension the appearance of the possibility that complete growth of the companies' dimensions and in the end to be materialize into monopolies. This kind of growth will draw an exponential increasing of the transfer prices through significant spending, organizational and administrative costs and through opportunities costs, from limited reason, which will restrict the European firms on the union external market, from a competition point of view.

The theoretical recognition of this scenario implies also the admission of that limit where European custom politics couldn't defend from bankruptcy the European firms. Don't forget that the EU market size makes that the space of European Union to be very attractive for external capitals and therefore, the opportunity of composing or processing of the efficient property structures it turns good use through these capitals.

There is a profitableness touch limit witch makes convenient the actions of all these capitals, regardless of the tariff and administrative barrier and which is in interest of the European capitals. The predictable outcome can be an economy which is strongly vertical integrated, with a higher development potential and where the main process beneficiaries will be the less developed regions at the moment. The previous experience of the union

creation shows that the recovery to a higher development potential was attributed to those region.

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